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SMG - Q2 2017 Scotts Miracle-Gro Co Earnings Call

EVENT DATE/TIME: MAY 02, 2017 / 1:00PM GMT

OVERVIEW:

Co. reported 2Q17 Co.-wide sales of $1.2b and GAAP income from continuing operations of $165.3m, or $2.73 per diluted share.

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PRESENTATION

Operator

Good day, everyone, and welcome to the 2017 Second Quarter Earnings Conference.

Today's conference is been recorded.

At this time, I would like to turn the call over to Mr. Jim King. Please go ahead, sir.

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

Thanks, Dana. Good morning, everyone, and welcome to the Scotts Miracle-Gro Second Quarter Conference Call.

With me this morning in Marysville is Jim Hagedorn, our Chairman and CEO; Randy Coleman, our CFO; as well as Mike Lukemire, our President and Chief Operating Officer. In a moment, Jim will share some prepared remarks related to our first half results as well as the announcement we made today about the binding offer we have entered for the sale of our European and Australian consumer businesses. Randy will then cover the financials, after which we will open the call for your questions. (Operator Instructions) If we don't get to everyone or there are further questions you'd like to ask, feel free to call me directly later today.

One piece of IR housekeeping before we begin. Randy and I will be attending and presenting at the William Blair conference in Chicago at 7:30 Eastern -- Central time, rather, on Tuesday, June 13. Please contact the conference coordinators directly if you want to attend the presentation or set up a one-on-one meeting.

Moving on to our work this morning, I want to remind everyone that our comments will contain forward-looking statements. Therefore, actual results could differ materially from what we discussed. Please refer to today's press release or our Form 10-K to familiarize yourself with the risk factors associated with our business.

I also want to remind everyone that today's call is being recorded and transcribed. A recording of the call will be available, beginning later today, on our investor relations website.

That's it for me, so with that, let me turn the call over to Jim Hagedorn to share his thoughts.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

Thanks, Jim. Good morning, everyone.

I'll jump right into things because we have a lot to cover with you this morning.

As you read in the press release, we've taken another big step in reconfiguring the corporation with the binding agreement to sell our European and Australian consumer businesses. This is an extremely positive move for everyone involved, and I'll elaborate on that later. As you also can read this morning, our core business in the United States is having a solid start to the year, despite an extremely difficult comparison from a year ago, when an early break to the season resulted in a double-digit increase in consumer purchases and record sales. We obviously continue to be energized by the potential of hydroponics, as Hawthorne Gardening Company delivered another quarter with comparative sales growth of greater than 20%. Beyond these headlines, we're close to finalizing deals that will make Hawthorne even stronger. We're in the midst of changes that will further improve our cash flow. And we've begun conversations with some of our retail partners to ensure that our success with next year's lawn and garden is going to happen.

So I continue to give our team outstanding reviews as it relates to our execution against Project Focus. I'll let Randy get into the details on the numbers, but my advice is to avoid getting overly focused on the absolute results for Q2. As all of you know, April and May are the 2 most important months of the year, and June isn't too far behind. Those 3 months alone make up more than half of consumer activity for the year.

I'll start by saying the decline we saw in the top line during Q2 wasn't particularly surprising. You might recall that the weather last year in the early part of the season was phenomenal. And POS during the first half of 2016 was up more than 12%. During March of this year, we had weeks where we were up against comps that were well above 50%. At the end of March, year-to-date POS was down 3%, so the fact that we're nearly flat at our top 4 accounts entering May is a positive sign. To provide more context, you should know that POS is actually up 5% against the 3-year average. Our forecast for shipments entering May, at least right now, is on pace with the guidance we provided entering the season, so I feel pretty good about where things stand.

Let me provide you just a little bit more color on how the season is breaking. While we've had a slower break to the season in the past 2 years, spring this year is more naturally rolling up from the South to the North. Let me give you 2 examples. The best example of the slow start to the season was in the Northeast, which a week ago was down 5% on a year-to-date basis, but over this past weekend, when the weather finally cooperated, we were up 35% in the region and made up the entire gap in a single week to enter May flat from last year. If you compare the Northeast to the mid-Atlantic, you'll get a sense of why we believe the next few weeks will be strong in late-breaking markets. In North Carolina, which has had a great spring, POS has been up 5 straight weeks, 3 of them by double digits. And consumer purchases in the state are up 3% for the year. Texas is also seeing some good POS numbers. And California is back in positive territory now that the drought has ended and strong spring rains have allowed things to start greening up again.

Beyond the broad POS results, I also want to share a few of the trends we're seeing by category. Most notably, we're pleased with the amount of support we're getting for our new Roundup for lawns products. We have some good real estate in the stores, and consumers are engaging as well. We entered the year believing this could be a $45 million launch, and we remain confident that, that will happen. While we're seeing a bit of cannibalism from our Ortho products, it's not as much as we anticipated. Overall, consumer purchases of all of our weed controlled (sic) [control] products are up 17% entering May, making it our strongest category. Our lawns business is a bit of a mixed bag. POS of grass seed is up 10%, but fertilizer is down 2%. Remember, though, our fertilizer business is over-indexed in the Northeast and Midwest, so I'd expect to make up some ground here in the next few weeks. The greatest evidence that weather has held back the season is in our gardening business. The live goods industry has been very slow out of the gate because it's just been too weather cold in the Midwest or Northeast to start gardening. That means Bonnie is also seeing a slow start, but where gardeners are gardening, we're seeing nice benefits from our partnership with Bonnie. Again, it's too early to get an early -- to get a read on the business, but so far, we're seeing more consumers trading up to higher-margin potting mix products as well as raised beds soil products introduced this year under the Nature's Care brand. We've also seen a nice bump in the share numbers of our plant food business, a good sign as we enter the peak weeks for gardening.

Overall, consumer purchase of soils is down a little more than 2 points entering May, but at the risk of being repetitive: This is against a high single-digit comparison, so we're not surprised or concerned. Remember May alone represents almost 1/4 of our soil business for the year, so the next 4 weeks will be critical.

All of you know that I'm no fan of red numbers, but I'm sharing them with you for a reason. We've seen this situation before, many times, in fact. We continue to feel good about the season. And we're confident that our retailers will stay engaged, especially those who view lawn and garden as a destiny -- destination category. While I don't like to talk about specific retailers, it's hard not to talk about what we've been seeing at Ace. For the second year in a row, the aggressive approach they've taken to supporting our brands is resulting in some very nice growth. Convincing all of our retailers to take this approach is on us. I've been in the seat as CEO for 16 years, and I've been in this business most of my adult life. What I know is that our brands have fans, not consumers. Retailers who lead with our brands tend to win, often at the expense of those who take a different approach. Our job is to keep all of our retailers in the category through the entirety of the season. That task is especially important in a season like this, so rest assured we're on it. Overall, I feel good about the core. And I expect we'll finish up somewhere between 1% and 3%, in line with our guidance and what we've been seeing out of the business for the past several years.

I feel even better about Hawthorne. You'll see in the press release that sales in Other segment were up 50% in the quarter and 59% through 6 months. Most of that came from the acquisitions of Botanicare and Gavita, but when you peel back that number, you'll see organic growth for Botanicare of 13% in the quarter and 12% year-to-date. Gavita is up 33% in the quarter and 18% year-to-date. When you layer-in General hydro and AeroGrow, both up double digits as well, unit volume for the entire hydroponics portfolio was up 22% for the quarter, which leaves us up 13% through 6 months. The overall landscape continues to look positive for Hawthorne. We would expect to see new sales opportunities to start to emerge in markets in the Eastern United States like Florida, Ohio, Maryland and Massachusetts in the quarters ahead. And we continue to expect more opportunities coming from an already strong West Coast markets like California.

As I said at the outset, we've been exploring some growth opportunities for Hawthorne in recent months that would lead to further expansion of their portfolio and allow us to appeal to a broader range of customers. We expect to complete most of these deals by the end of the year. Randy will tell you in a few minutes that interest expense, so far this year, is better than expected because we've been moving slowly through the M&A pipeline. I know I've talked to you in the past about a time line for closing the M&A window, but the truth is the deals we're looking at are just taking longer than we expected. In the hydro space, as well as live goods, this is mostly because we're talking to family-owned businesses. They often don't have the systems in place to provide information quickly, and the family dynamic often is a complicating factor, but we are making good progress working our way through the pipeline and our goal remains the same: to shift our focus to integration and returning cash to shareholders.

Speaking of deals, I want to transition to the other announcement we made today, which is the binding agreement for the sale of both our European and Australian businesses.

I'll start by tipping my hat to the deal team here, primarily Randy, Dimiter, Katy Wiles, Dale O'Donnell and Phil Jones. We put a deal book together earlier this year, and there was far more interest in the business than we had expected. The economics of this transaction, roughly USD 250 million, will give us cash proceeds of roughly USD 150 million. Randy will give you a more comprehensive description of the terms, but this is better than we would have expected 2 years ago when we first started to explore strategic options for this business. To be honest, this is a bit of a bittersweet moment for us. The businesses we're selling are good businesses. In fact, international is out of the gate strong this season, which reinforces the challenge that this was not -- it was not the business. It was our ownership. We know we have better growth and margin opportunities in the United States, and that's where it makes sense for us to invest. If we're not willing to invest in these other businesses, then we owe it to everyone, especially our associates, to put these businesses in hands of a better owner. I believe that Exponent is the right owner. They're excited about the category, our brands and the opportunity to grow.

Since this is likely my last time to publicly do so, I want to thank and congratulate our associates in these businesses. My career in lawn and garden started in Europe when my father sent me to England to launch Miracle-Gro. I know what this industry is like over there. I know that it's more complicated, more competitive and just flat-out harder than the United States. Our people in Europe and Australia have done an outstanding job and probably haven't always received the credit they deserved. I want to thank them and wish them good luck with Exponent. I also want to thank the friends I made along the way on the retail side of the business. I'm really going to miss you guys.

For our shareholder, the proposed sale is further proof of our commitment to reconfigure this company. Once this deal closes, more than 95% of our sales and profit will be derived from the United States. I know that we'll see up to $0.20 of near-term dilution from the sale, but we'll get that back quickly both through acquired business that have better growth and margins as well as through our share repurchase activity.

It's too easy to simply look at the valuation of this deal and the P&L impact and leave it at that. I think it's worthwhile to put this deal in a broader context. Just 18 months ago, we announced the launch of Project Focus. It was the most substantial change of our strategic plan since it was -- since we created the modern-day Scotts Miracle-Gro in the late 1990s. In a remarkably short period of time, we've done an outstanding job of maximizing the value of noncore assets like international and Scotts LawnService. Our hydroponics acquisitions are significantly exceeding expectations. And investments in adjacent categories like live goods are proving that they also have significant potential. As we begin planning for fiscal 2018, we are a vastly different company. We have a clearer vision of the future, a better margin structure, a solid plan to improve our fee cash flow and a serious commitment to returning more cash to shareholders. We've also completely overhauled our compensation structure to better align ourselves with the shareholders. So the pending sale of Europe and Australia is more than a bullet point in a press release. It's more than a discussion about how to offset a few cents of dilution. This transaction is a real indication that we are serious about driving shareholder value.

I'd be remiss if I didn't give everyone a heads-up on a matter indirectly related to this transaction. For the past 6 months, we've had a high degree of confidence that we would be able to complete the agreement we announced today, but during that entire period, our trading window has been closed to insiders. Our trading window will open again later this week. Given the seasonality of our business, we'll close it again in a few weeks and keep it closed until August, so don't be surprised to see some insider sales, but please don't mistake that for a lack of confidence. Every member of the team will remain in strict compliance with our ownership requirements. And each of us is highly confident that shares have upside from here.

Before I turn things over to Randy, I want to share a thought about the current climate in D.C. and put it in the context of Project Focus. More times than I can count during my tenure as CEO, I asked our tax department to find a way to get a lower tax rate, which is the highest you'll find among publicly traded consumer products companies. So I have to applaud the news last week because Scotts Miracle-Gro is a taste of on why something has to change. Next year, we'll celebrate our 150th anniversary. We've been in the same small town since 1868. We derived nearly all of our sales and profit from the United States. We are the quintessential American company. Even though we're investing harder than ever in our American business, the operating environment is frustrating. A material reduction in the corporate tax rate will give us the ability to invest in those areas of our business where we see greater opportunities for growth, allow us to create more jobs and to increase our contributions to communities where we live and work. A clean reduction in the corporate tax rate, one that stays away from offsets like border adjustment, is good for us. It's good for our partners. It's good for our associates, and it's good for the country.

The President's commitment to regulatory reform is also welcome news. I want to be clear: I support the EPA and believe it serves an important role in protecting consumers and the environment. We've been a major registrant of the EPA since its inception, so I can speak with firsthand knowledge in saying that the regulatory framework has become more cumbersome, more expensive and more time consuming in recent years. I wish I could tell you that those changes have better protected our consumers and the environment, but I just don't see it. These are not meant to be partisan comments, and my focus is really on business, more than politics, because here is the truth. Again this year, our company and most other consumer products companies in America are going to see anemic growth in our core business. In fact, the entire universe of consumer stocks is approaching a full decade of seeing 1% or 2% growth. Lower taxes for both consumers and businesses, I believe, will help break this logjam and stimulate higher growth. And regulatory reform that better balances protecting the public while getting rid of needless bureaucracy is a benefit for all of us.

Thanks for your time this morning. Let me turn things over to Randy to run through the numbers, and then we'll take your questions.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Thank you, Jim. And good morning, everyone.

Jim has already given you a fair amount of color as it relates to the start of the season, so I'm going to stick to the numbers. Where needed, I'll help to fine-tune some our guidance for the full year as well. At the end of my remarks, I'll share a few thoughts about the likely impact of our international sale announcement. And then we'll move on to your questions.

Our top line results in the quarter are pretty straightforward. On a company-wide basis, we saw a 3% decline to $1.2 billion. That was driven by a 7% decline in U.S. Consumer to 2 -- to $963 million and an 8% decline in Europe to $105 million. The Other segment grew by 50%, as Jim said. It was primarily due to impact of acquisitions and also strong organic growth within Hawthorne. As for the U.S. business, I concur with Jim's view that our Q2 results are a timing issue because of the record comparison numbers from 2016. If I fast-forward to today, we remain confident about the 1% to 3% sales growth guidance we provided for the core business. I feel good about POS numbers given the phasing of comps from last year. And the level of engagement we have with our retailers and consumers remains encouraging.

Let me move on to gross margin, which is a better story than you might assume by simply looking at the P&L. The rate in the quarter was down 20 basis points from last year to 41.7%. On a companywide basis, materials and acquisitions effectively offset each other. And the benefit of pricing was offset by the loss of fixed-cost leverage during the period, but if you break down gross margin by segment, you will see a 60 basis point improvement the U.S. Consumer business. That benefit was offset by the impact of acquisitions since Hawthorne has a lower gross margin rate, as well as declines in Europe due to higher costs related to Brexit, as well as a mix shift toward a higher percentage of lower-margin growing media products. These headwinds were largely anticipated going into the season. We said going into the year that we expected the gross margin rate to improve 50 to 100 basis points for the full year, and that remains the case. Commodities are really a nonstory in the rest of the season, and nearly all of our raw materials have been acquired already. And in fact, we've already locked in about 30% of our urea needs for fiscal 2018.

Let me move on to SG&A, where there really is not much to say other than we continued to do a really good job controlling our costs. For the quarter, SG&A was actually down 2% to $198 million despite a $6 million impact from acquisitions. Through 6 months, SG&A is up 1% from last year. Our guidance for the year has been SG&A increases 6% to 7%, essentially in line with companywide sales growth when including the acquisitions. Clearly, that guidance assumes significant growth in SG&A over the rest of the year, so let me provide a bit of color. The SG&A growth in the second half is largely due to 4 factors: number one, expenses like media, marketing and R&D that are either phased with sales or impacted by timing of initiatives; two, acquired SG&A from Gavita, Botanicare and other smaller deals; three, investments in Hawthorne, for example, implementation of SAP across our acquired businesses; and four, incentive compensation, both short term and long term. Right now, I'd stick to the guidance we provided. However, we do have some flexibility and discretion in our spending plans, providing us with confidence in our bottom line guidance for the year.

Let's move on to the equity income line, which is mostly related to our minority ownership in TruGreen. The adjusted non-GAAP loss we reported in the quarter was $22 million, and we're at a loss of $25.6 million year-to-date. Some additional context is important here, so let me explain. I told you going into the year that we expected our equity income for the full year to be flat from 2016 levels at roughly $5 million. Right now, however, I'd tell you there's potential risk to that guidance and we could be as low as breakeven on the year. Note this outlook simply reflects TruGreen's anticipated phasing of earnings over its calendar year plan and expectations of a slower start to spring but a better fall season compared to a year ago. There is no change on a calendar year basis, only a difference in phasing versus the original guidance provided by Scotts. Importantly, though, I want to stress that on a peer operating basis TruGreen is actually right on plan, so far. Their business, like ours, saw a year-over-year dip in March, but they expected and planned for that reality. In terms of the integration, the $50 million in cost savings we anticipated when announcing the deal is materializing as expected. And in terms of our full year guidance in your models, getting back to breakeven means we would expect our equity income in Q3 to offset about 60% of the year-to-date loss through 6 months, and the balance will be offset in Q4.

Getting back to the P&L. Interest expense was $21.5 million, up $2.5 million in the quarter compared to last year. Year-to-date, we're at $37.1 million compared with $35.4 million last year. Interest expense is likely to be lower than we expected on a full year basis simply because of the timing of our M&A work. I would expect the lower interest expense would essentially offset the shortfall from equity income.

Taking all this down to the bottom line, GAAP income from continuing operations was $165.3 million or $2.73 per diluted share compared with $225.8 million or $3.64 per diluted share for the second quarter of 2016. Remember, though, our guidance is based on a non-GAAP adjusted result taking into account the divestiture of SLS; and excluding impairment, restructuring and onetime charges. On that basis, non-GAAP SLS divestiture-adjusted income was $168.7 million or $2.78 per share compared with $186.6 million or $3 per share.

Let me shift gears a bit here and provide some color on the international transaction we announced this morning. I want to start by sharing my belief that this was an outstanding result for the company, our people and for our shareholders. By taking a patient and prudent approach, I believe we executed a transaction that worked to the benefit of everyone involved.

The deal is valued at EUR 230 million or about $250 million based on today's currency rates. From a timing perspective, I would expect to close the deal in the first half of the fourth quarter. The net cash proceeds of the deal, roughly USD 150 million, including a $22 million earnout and excluding a $27 million loan to the buyer, will be reinvested to offset the expected dilution we'll see, which could be up to $0.20 a share in fiscal 2017. We expect to largely offset that dilution next year, in fiscal 2018, by using the cash proceeds for acquisitions and share repurchases in both fiscal 2017 and 2018. I don't want to adjust our earnings guidance quite yet just in case we get delayed on the closing, but assuming everything goes as planned, we will make that call later this summer.

While the dilution is a bit more than I shared with you earlier in the year, the issue is simply timing. It took longer than we expected to get the deal signed, and we really won't have enough time left in the fiscal year to replace any of the lost earnings. In terms of the cash proceeds, if we completed all the deals in our current M&A pipeline, it would exhaust the proceeds of this deal and then some, but because our leverage right now stands at only 3.2x, we have more than enough capacity to fund anything left on the table. But once the deal is complete and these businesses moved to discontinued operations, our operating margin on a companywide basis should improve by as much as 125 basis points. Said differently, the combination of hitting our earnings target for the year, coupled with this transaction, will improve our companywide operating margin to a range approaching 17% or about 400 basis points higher than we were at end of fiscal 2015.

I want to reiterate Jim's enthusiasm for the progress we've made against Project Focus. Over just a 6-quarter period of time, we have vastly changed our portfolio as well as the key operating metrics of the business. We will enter fiscal 2018 as a more focused company with a higher margin profile and a more intense focus on improving our free cash flow. Project Focus is far from being complete. We still have some acquired growth that we're pursuing, and we remain committed to returning a significant level of cash to our shareholders. I still expect us to repurchase about $200 million of SMG shares this year. And we would expect, as we do in most years, to announce a mid-single-digit percentage increase in our quarterly dividend later this year.

I've just wrapped up my 3-year anniversary as CFO. When I first started in the role, I wasn't sure what to expect from the public-facing nature of the job, but I'll admit that interacting with the investment community has become one of my favorite aspects of this role. I'm not usually one to play the role of cheerleader here, but I am tremendously encouraged by the progress we continue to make. I want to applaud everyone in Jim's team and also our broader team associates for their execution of this plan and for delivering on the commitments we made to our shareholders. Like Jim and my other colleagues here, I believe we still have a lot of upside ahead of us.

With that, I want to thank you for your time and open up the line to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll go first to Jeff Zekauskas with JPMorgan.

Jeffrey J. Zekauskas - *JP Morgan Chase & Co, Research Division - Senior Analyst*

How much was POS up in April year-over-year? And what was POS growth in 2016, in May? If you have that data.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Sure, Jeff. So April this year, we were up low single digits versus year ago and in May last year was down about 4%...

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

4%.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Year before that, we were down about 7%. So it gives us a lot of reason for the optimism we're expecting for the month of May.

Jeffrey J. Zekauskas - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Okay. And then in divesting your Australian and European businesses, are -- is there a significant amount of stranded costs that will be -- that will remain? And do you have a plan for eliminating them? Or how much are the stranded costs that would remain that are attached to those businesses?

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Sure, Jeff. So our stranded costs are $2 million to $3 million, so it's not a tremendous amount of burden. We're thinking about how we might cover that, but we're also spending a lot of time on the corporate end pursuing acquisitions, integrating acquisitions and so on. So I think it's a good thing that we're only talking about a couple pennies, maybe $0.03 for next year, but as we plan ahead for 2018, rest assured it's top of mind for us as we go forward.

Operator

We'll go next to Bill Chappell of SunTrust.

William Bates Chappell - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Just first, on the sale of the European business, I'm just trying to understand the $0.20 dilution number. I guess, first, is that what it would be -- I mean, what would be the dilution if it had been sold at the start of the year? Because it seems kind of like a big number for only maybe 2 or 3 months left in the year. And then trying to understand how you offset it: Does that mean deals that you already have in place and/or repurchase you already have in mind can fully offset it day 1 as we move into 2018? Just trying to understand those comments.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Right. So Bill, when we said $0.15 last quarter, we were thinking that we would wrap up the divestiture a bit earlier. And then we'd have that cash, and some of these other M&A activities we have in the pipeline would get done by now or in the very near future. At this point, due to the timing, everything has just been pushed back, both the sale as well as the acquisitions that are in the pipeline. So that's why we've changed the number a little bit. I think we're still very much on track for the deals in the pipeline, but as Jim said in the script, things are just taking a bit longer on both ends.

Michael C. Lukemire - *The Scotts Miracle-Gro Company - President and COO*

And I think we said up to $0.20, just to be clear.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Right.

William Bates Chappell - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Well, I -- and I was just trying to understand. With that -- the deal being pushed, it would seem you'd own it for a bigger part of the season, so it would actually be less than the...

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

Yes. See, I asked that question earlier, so I learned a new word, disc op. So it basically falls in discontinued ops, so it gets excluded from a financial point of view from the EPS calculation. So the earnings are there. The cash is -- still is ours. [But] this doesn't show up in earnings because we've put it in discontinued ops.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

And we'll take the results not only in '17 but prior years as well, so it will be apples to apples when we look backward and look forward.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

I'm looking back to the financial team there, like, "Give me thumbs up." Like I said it right.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Yes, way to go, Jim.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

All right.

William Bates Chappell - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

And then just switching back to the core business. So as a reminder, a year ago, I think POS, when you reported, was up 1%. And you're seeing it was down 4% in May and then it was up pretty strong in June. Is that correct? So well, we have a -- I guess, an easy comparison over the next 3, 4 weeks, then June gets a little bit tougher.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Yes, that's true. Last year, June was up about, it's like almost, 11%. And then after that point, July was pretty slow. August was up a little bit. And September, we had a nice start to the fall. So that's what you should expect month by month as we look over the balance of the year. But when you think about the biggest months of the year, it's April, May, June, March. Well, December is not as important for...

Michael C. Lukemire - *The Scotts Miracle-Gro Company - President and COO*

Yes. And Bill, the season is trending about 2 weeks behind last year.

William Bates Chappell - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

But just the question being overall do you feel like the category is pretty healthy in what you're seeing, not just your share, but it's in pretty good shape.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

I think that's the case, but it's a long season. It's a big country. I think, by the time we get to the end of the year, we typically end up where we think we will. And it's just, this point in the year, you just -- we're living day-to-day, week-to-week.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

Look, I -- listen, I think that we talk about this so much. I think where [Luke] and I have sort of gotten to for like this year is this is just another year where we're going to -- I know you all think we work our asses off all the time, but we do dream and fantasize about those seasons that'll be so positive at the beginning through kind of middle to the end of May that we can just basically relax and sort of count our shekels. I think that ain't happening. And so where are we this year? I think this is another year where all parts of the season are going to matter, meaning getting through the core part of the spring. Remember it -- in the northern part of the country, nobody is gardening yet. And so there's still frost opportunities and so people aren't putting like a lot of live goods out, so the -- you've got to sort of put it into prospective just saying the season is still young. But I do think this is the season we're getting out as well as we can out of the core sort of spring season. The summer pesticide season is going to matter where insecticides and herbicides, fire ant is all going to be important. And then fall is going to matter. So I think it's just -- look, we fantasize for these crazy good years. I think where Mike and I are at is the operating team is going to work all summer and through the fall, and that's -- and then do it all again next year. So -- but I think that the important thing for the community that's listening to us is that nobody is freaking out. Nobody is suicidal. We've been here before. We -- this is what we do. And I think everybody is feeling pretty reasonable about the year. And so the -- I think that's kind of what we're trying to communicate here.

Operator

We'll go next to William Reuter with Bank of America Merrill Lynch.

Janani Reddy Ganta - *BofA Merrill Lynch, Research Division - Analyst*

This is Janani on for Bill today. So I'm wondering. How do you feel about current inventory levels just given some of the weakness in the gardening segment in 2Q? In other words, do you believe there's excess inventory built up because of the unfavorable spring weather? And as a follow-up, are you still optimistic you can reduce working capital levels by $30 million to $40 million this year?

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Sure. So this is Randy again. And we'll think about retail inventory first. We're seeing slight declines in retail inventory, so nothing dramatic but pretty much what we expected coming into the year. I think home centers in particular, last year, they were saying, "We're going to be a little more focused on working capital," so that's what we've seen play out. We don't think we're missing POS as a result, so we're comfortable with where we are. But not a buildup. I'd say slight decline. Right now, we've seen that more or less over the early part of the season. When you think about our inventories, we still believe that we'll see improvement in working capital this year. And we think our operating cash flow for this year should start with a 3. I don't want to be much more specific beyond that, but we feel really good about the cash flow improvement year-over-year. Mike, do you want to add anything?

Michael C. Lukemire - *The Scotts Miracle-Gro Company - President and COO*

No. I think we're working with retailers on their inventory as well as ours, and I think we're in better balance. And most of the stuff we have to bring in is like about space, which is soils, which is the biggest part with the growing season that's coming.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

So I think that, when you asked the question, Randy and Mike were both nodding their heads no to is there an inventory issue. And I agree with Mike. I think what we want to do is we'd like to see a lot more of our bulk products in the stores right now. So I would say there's no problem and we're not getting a lot of pushback. We -- but I think that it's [third time], so we'd like to see a lot of pallets in the store.

Operator

We'll go next to Joe Altobello with Raymond James.

Krystyna Metcalf

It's Krystyna on for Joe. I was wondering if you could tell us what drove the improvement in the U.S. Consumer segment in margins.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

So in U.S. consumer, it was -- commodity costs have been favorable, just about cost of category. But the one area that we're seeing some pressure over time has been in peat that we source from Canada. But urea is in pretty good shape, fuel has been pretty good. So commodities have helped a little bit. We've taken some pricing that's been accretive as well. And those are the 2 primary drivers so far -- headwinds so far, as volume is a little bit less than planned through March when we're talking about March results. But we think we're in good shape and have confidence about our gross margin rate for the full year that we had outlined earlier.

Krystyna Metcalf

Great. And then, if possible, could you tell us what the EBITDA multiple is for the European deal?

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Well, there's earnout attached to that, so I guess I'd just probably call it double digits and could be a little bit better than that as we achieve the metrics required or achieve the earnout, which is a couple of years from now. So we feel good about the valuation received when we started going through this process over 2 years ago. We had much more modest expectations, though. We think we could come up with a really good deal for shareholders and done some good work by everybody involved to, not only negotiate a successful deal for both parties, but find a way to, when it comes to the cash proceeds, we're going to net out at the end of the day. We feel really good...

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

Facing considerably at north of 10.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

North of 10. But much better cash proceeds than we would have expected. So really going to help us pay for a lot of the deals that we have in the pipeline as well.

Operator

We'll go next to Chris Carey with Bank of America Merrill Lynch.

Christopher Michael Carey - *BofA Merrill Lynch, Research Division - Research Analyst*

So just first on the core business. So in addition to simply having easier comps from here, can you talk about any other successes you're seeing with in-store merchandising or it's new products that gives you confidence in the 1% to 3% for the core business for the full year? For example, we've been seeing more ad spots, just like the Roundup. I wonder, how you would gauge the success there? And any additional activity that you think is relevant to your outlook for the year?

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

What I think Roundup for lawns is a big success. It's actually exceeding our expectations at this point, and that was about $45 million totaling new product. It did cannibalize Ortho a little bit. Also the raised bed garden soils is doing very well. And we're actually looking -- that is actually double-digit comps or double-digit results, and so we're excited as full planning takes place. And that association with Bonnie and soils is -- we're trending ahead even though we were a little behind just because of the late spring.

Christopher Michael Carey - *BofA Merrill Lynch, Research Division - Research Analyst*

Okay. Thanks. And then on M&A. So the $150 million in cash proceeds represents pretty expending power in the Hydro market, right? So where do you guys see gaps in your portfolio right now? And it's a multi-part question, so I apologize. But -- and then can you maybe talk to the national attention in the organization of wanting to be in shifting toward more of a consumer-facing company with the fact that many of the opportunities that might be coming, and Hydro might be of a more of a commercial B2B nature? And then how do you think about growth in California? And then in Canada, where I think your Hydro business is very small.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

How many questions can you ask as part of 1 question. Somebody better write that just (expletive) down, so like we can remember all that stuff that you god damn said.

Christopher Michael Carey - *BofA Merrill Lynch, Research Division - Research Analyst*

Or bigger, just what do you think about Hydro?

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

Well, listen. I'll take sort of part of this, which is our strategy. And the answer will get right to Hydro. I think if you look at our strategy, a lot of what we've done is sort of embrace the reality. We love our core business, but I think we view it as somewhat mature and slow-growing like lots and most other consumer goods companies. I think what we've done right, and I think we've gotten credit from you guys and from our Board and from our sort of shareholders, is that what we've said, is if we can be something else, arguably lawn and garden, what would we do? And we've looked at, and I'm just going to sort of deal with sort of the big categories. But this, for a demo side business for us continues to grow significantly double digits. And we've taken share. It's been a great acquisition for us. And the team has done really well, and our partnership with Bell has been important to us. Live goods is also an area that is growing, it's sorts of 2x to 3x the rate of -- sort of, call it, core lawn and garden. And the same is true with Hydro. It's probably more than that, call it, 5x, 10x faster than what we're seeing in the core. So effectively what we've done is that if growth is important, which we think it is, and we think the core is somewhat challenged, and there's a point where you say, why is this too hard in the areas, can we reconfigure into higher growth areas? And so the divestitures that we have announced today, plus what we've done with Clayton Dubilier, with LawnService, really has allowed us to sort of fund this move into more growth categories. So just try to simplify what we've been doing, we're really buying growth in categories that we believe has sort of systemic grow higher than our core. And I think that's completely rational and what a team of executives is supposed to do for the owners of the business. And if you look at the valuations of the deals that we've done, I think just look at the multiple on this. We're effectively paying less on ad on Hydro side for higher growth and higher margin. So we like it. Now do we think there are areas within Hydro that there are opportunities, which is the kind of the other part of the question? I think the answer is, we do. And so a lot of the core of that Hydro business for us -- lighting is important. So I think, we're continuing to look at the lighting market. I think that there's a lot of sort of fluids control systems, HVAC, I think we call it air, but it's not just heating and cooling. It's movement of air and sort of maintenance of the environment within a growing area. I think these are largely the areas that we think there's opportunity. So I think we explained this to you guys, like maybe the last call, the call before that Chris Hagedorn and his team went off-site with, I think, really the brain trust for the most successful people in Hydro. A lot of them now part of our team, but some that weren't. And looked and said, what should this footprint look like in a couple of years? And I think they viewed, what I think Chris and his team call pillars, that there were a couple of pillars that I think I've broadly described to you that we didn't plan on and that we felt were important. And that if the company is going to have the answers for the community of growers, then we probably ought to play in that area. Randy and myself -- and I'll give credit for the entire team, our strategy team, Mike and the operating team, Randy and his finance group, as we built this plan out, it's pretty meaty. And capital structure is a gigantic part of this, which is, is it all fundable and does it interfere with this idea of going back to shareholder-friendly? And so while the transactions are coming in a little bit slower, and I got to say, a little frustrating, they are all built into our budget, and they are all consistent with what we've told you guys, meaning, they were effectively embedded, even though you didn't know it, within the discussions we have been having with you over the last, call it, almost a year. So there's really nothing new in our M&A pipeline than what we've talked about. It's just realizing it's been a little bit harder, meaning it's just taken longer. But the deals, nothing has blown up, the pricing has been very attractive, I think from our point of view. They are funded, meaning the Board is aware of them, the Board -- some of the deals were prior approval by the Board separately just as they happen. But broadly, the Board has approved them. And so I think we're in a good place to sort of make sure that the pillars that Chris and his team want to play in that we have passed to sort of be serious players in those areas. And there were probably other parts to the question that I didn't get to, I'll leave to Randy.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

No, I think you covered it, Jim.

Operator

We'll go next to Eric Bosshard with Cleveland Research company.

Eric Bosshard - *Cleveland Research Company - Co-Founder, CEO, Co-Director of Research, and Senior Research Analyst*

Two questions. First of all, Jim, you've mentioned earlier in the discussion that you're speaking with retailers already about some thoughts on how to perform better in the core business in 2018. Could you elaborate a bit on that?

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

No. Listen, I think what I meant to say, I stumbled a little bit on that part of the script actually. I think because of like whatever crap that King wrote and that was just hard to read. What I was trying to say was that we are... Sorry, Jim.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Take the bullet.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

What I was trying to say was that we were in negotiations and discussions already with our prime retailers for next year. And so I think we have a team on the road right now at one of our big retailers. I mean the entire sales team and marketing group is at one of our big 3 right now, and all these discussions are turning from this year, which is kind of an executional play to planning out for next year. But I think that if you look at this year, I think we went into the year feeling good about the programs we have, had and have. And feel, I'm going to say, genuinely confident in sort of the relationship with the retailers and their desire to play in the space. I think MATs continues to be an area of, I think, focus and concern for us. But I would say our sort of hardware retailers -- and when I say hardware, that includes Big-Box, DIY, I think continue to be engaged and really looking to improve programs for '18 and to exit '17 or exit -- execute '17 in a successful way. So Mike, anything you would add on it.

Michael C. Lukemire - *The Scotts Miracle-Gro Company - President and COO*

No. I think we're working on solutions and increasing the market basket and how they merchandise various segments of the store. Each retailer -- it's all about solution selling. And so we have a number of tests that are out in the field right now. And we're seeing to getting the results and then we're going to see if we're going incorporate that in and raise the deal overall category.

Eric Bosshard - *Cleveland Research Company - Co-Founder, CEO, Co-Director of Research, and Senior Research Analyst*

In terms of -- just as a follow on. In terms of what retailers are thinking with private label or what's going on with organic or where price points are, do you feel better, the same or worse about sustaining this kind of low single-digit growth in the core business?

Michael C. Lukemire - *The Scotts Miracle-Gro Company - President and COO*

I feel about the same. I mean, there's a balance of private label, and I think private label and brand going together, I think most of our retail, this is imbalanced, I would say. So I'd go too far and able to share and we're trying to get them back to a normal level.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

But, look, I -- there's been so much press lately about sort of consumer goods, particularly in the journal. As private label and people moving to sort of fresh foods -- first of all, I think fresh foods and all, that is good for our business and growing. And I think it's good for Bonnie, it's good for our soil business, good for our nutrient business. So I think we're actually -- good for our AeroGarden business. I think that we're actually in a pretty good place, if that part is true. I don't think we're seeing, particularly in our sort of core accounts, and I will call it hardware, I don't think we're seeing this sort of crazy push toward private label. So I think that I would make a little bit of an argument that part of what you're seeing there is the strategy of mass retail and a push toward private label. I will personally say, I think it's a gigantic mistake. And I think it will hurt them. Now we're -- we play in private label and our brands are important and they -- we all can work together to sort of make sure that we're sort of in track with our major partners' strategies. Personally, the comments we put in the script, which were a little bit toned down, are designed to say, I don't think we've ever seen it work, but we'll continue to play. But I don't think in the vast majority of our sales that we're seeing a gigantic push into private label. I think it's a mass thing, and I think we continue to talk to mass retailer about that.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Eric, this is Randy again. The only thing I'd add is when you look past retailers and just think about it from a consumer point of view, that most consumers heavily shop our category 2x, maybe 3x a year. And they tend to want to buy the trusted brands and not want to take a chance on some private label product that may not work or work as well. So I've been here, I guess, 18 years today, and I've seen countless times where there's been new private labels introduced and different packaging and different campaigns, but we've been able to sustain our market shares over the entire period of time or even grown market share over time versus private label, just because I think you have to look past the retail strategy and look at what consumers do and how they really engage in lawn and garden.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

I'd throw another thing out there, only because we spent quite a bit of time at the end of the script on this issue of taxes. I am a believer, and I think that if Mike Porter and other folks that we rely on for sort of strategic advice were part of this conversation, I think one of things they say is a robust middle class is important. And so I do think that tax breaks for the middle class are not bad for us, they're good for us. And I think a stressed out middle-class and more and more people, and I think this has been kind of a Walmart thing for a long time is if you look at sort of Walmart POS, and this is not because I'm talking out at school, I think you all know this, that toward the end of the month or toward the end of a 2-week pay period. But whenever people are between paychecks, you see a big dropoff on sales it's because people are just living check-to-check. And I think that it's important for this country to throw some more money at a middle-class, then a middle class is healthy for us and I will make an additional pitch for corporate tax relief. 100% of the money that we benefit from, we intend to invest in the business, and as we working people, professional working people. And I think, so a stronger middle-class, more employment has got to be good for consumer goods, and that's why we said what we did in the script.

Eric Bosshard - *Cleveland Research Company - Co-Founder, CEO, Co-Director of Research, and Senior Research Analyst*

Okay. And then one -- that's helpful. One follow on if you could. As you learn more about the emerging hydroponics market, what's the most recent thinking on the current and eventual, call it, pro versus do-it-yourself mix in that business? And how do you feel about how your portfolio lines up with that?

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

I think really well for one, so I kind of back in from that point. I think we intend to be a significant player on both sides of sort of, call it, recreational growing and professional growing in the hydroponic space. And we have no sense of humor about that, okay? This is a space we understand pretty well. I think it was that a vis-a-vis question that was similar, which is it seems kind of like its pro. I agree with that, by the way. I think we understand the consumer here. We understand pro really well. We, as they move into our consumer business globally, as we divested our ProHort and our ProTurf business, this is a space we understand really well. We're basic in it. We're growing people. So I think we very much understand what it takes to be the best supplier to people who are professionally or recreationally growing plants for a living. And we intend to succeed in that space. And I would say to anyone who wants to like rumble with us, come on, let's do this. So really what I'm saying is, we are serious about what we're doing. We know what it's going to take to succeed. I think, right now, if you look at the space, we probably buy as a little more toward that recreational grower, small growers. I think our view is if you look long term in this business, there probably is a move toward professionalism, and that doesn't mean people aren't professional, but it just means that toward larger, more kind of professional growing. And if you look at our strategy of where Mike Lukemire is sort of demanding that the Hawthorne team go, and I think the whole Hydro group agrees with this. And our last Board meeting we had was in Colorado, so it was very much a deep dive in the Hydro. And we spent a lot of time looking at where do we think the future growth is going to come. So I think that, right now, it's a pretty good mix. I would argue with biases a little bit toward smaller growers. Our view toward the future is if things kind of normalize over time, and we talked about that as more and more states come online, whether it's in medicinal or adult use, that there will be more professional growing, like what we've used to seeing in sort of ProHort and ProTurf, and that we know how to play there. And so do we have all the products today? Do we have all the services? Listen, you've been following us a long time, one of the best guys following our business, I think. And so it's a compliment that I think deserved. Where we want to go with this business is not just to have the products, but to basically have a very technical sales force that's designed around supporting high-value agriculture in a way that we become a partner that's just is important to a grower in that space than it would be to a department manager in the Lowe's or a depot or any of our big retail partners, where they basically say, they are a fabulous vendor and there's very few people who have my private cell number, they're one of them, okay? Because when I have a problem, they are there, they are dealing with it, they are giving me advice. This is a space that's full of what we in the military call WARMS, a word or mouth. So there's a lot of technical, like sophistication that can happen in this space in this growing community to help that grower group be more productive and make more money. And we intend to take the business that we're putting together with all these pillars that we've kind of talked about, and then put together a sort of group of technical sales people that I don't think this industry has ever seen before, and become partners with people, not in an adversary way, but in a way that basically says, well, if it wasn't for those guys at Hawthorne, we would -- it would be a lot harder. And so we're beginning to do that kind of work. It's not unchallenging. We've -- I think, we've talked about this before, I even may freak out and jump across the table at me. But we're doing a lot of work up in Canada and in countries where R&D can be done, and the Board is comfortable with that, where we're learning more and more about these product and now to make them better and how to really be supportive of that community. So I think we're really excited about that. I think we have a big vision. I don't know that we've ever really talked about it like this before. But what I would say to you is, I think they're both important. I think, over time, you'll start to skew a little bit toward larger, more professional growth. And that doesn't mean that either is more important than the other, but it means that they're both important if we want to grow our business, and that's going to involve different products, tech support. And I think you talked about this. Is the existing business configured for larger growth? I think more and more than you know. I mean, and I know this because I've listened to all the people in Santa Rosa talk about it, Mike has talked about it, Chris and his team have briefed me on it, so I'm very comfortable where we're going with this. And I'm sorry for the long answer, but I think it was a good question.

Operator

We'll go next to Jon Andersen with William Blair.

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

So you called out a customer specifically in the prepared comments, Ace, and I thought it was interesting. I'm kind of curious what is Ace doing right? And why is it working and how to you get others to kind of replicate it, if that's a model that you really think is kind of the right model?

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

Well, Randy doesn't get to answer this one. This is a Mike and Jim one. This is people who are involved in the sales side. They're killing it, dude. Like if -- I see the CEO and a lot of these CEO things, and he's not like some stuck-up dude. The guy wants to get it on. He wants to drive the business. His team wants to drive the business. They take good ideas, they execute them quickly. They love to bring people in with our brands. And by the way, they have a robust private label program, too. It was not like they don't have a good private label program, they do. But they were leading with their brands and they were advertising like crazy. And let me tell you, like we just got POS numbers from that channel of trade just 5 minutes before we went live with you guys, and the numbers are ridiculous. So all I'm telling you is, they're killing it, they're -- like they're ready to fight and they are definitely taking share. And again, this doesn't mean we love them more than we love anybody else, it's just it's working. And it's partly because they have an appetite. They do not view us as the enemy, they view us a very essential partner and they want to rock. And they don't accept, "Oh, we are not a big box retailer. We can't compete." They are just going after it. And so I'm saying, and most of our retailers, by the way, are like that, in that they are enthusiastic, they are engaged. But the reason we call them out was because they deserve it. They are just -- this is like a multi-year commitment to the category and to brands that I would put it this way, if you want to look at sort of do you think that that's a better strategy than a like lead with your private label strategy. If you were looking at the numbers, you would say, that's sort of intuitively obvious. And that's what we're trying to communicate is that commitment to the brands, commitment to bringing people in, commitment to your market basket ultimately will lead to success for the retailer, and that it is not inconsistent with brands and private label, they work together really well. Mike, I think if you...

Michael C. Lukemire - *The Scotts Miracle-Gro Company - President and COO*

No, I think you said it all.

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

Okay. I wanted to ask about the TruGreen FLS joint venture. Just an update there. You're thinking on how that joint venture has performed to date. And what your kind of expectations are going forward? I know you kind of indicated that you're still looking for the $50 million in synergies. But ultimately, are you kind of happy with where that JV sits today? And maybe, more importantly, what are your intentions longer term there? How do you think that, maybe, plays out over time in terms of your building to monetize it or continue to stick within the P&L?

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

Well, I'm going to steal this from Randy. Randy and Mike are on the board. So they have much more sort of knowledge, I'm going to say sort of detailed than I do. But again, I would start by saying we felt it was really important whether we were the sort of big dog in the sort of partnership or we were part of the team that the combination made a ton of sense. And I think it's been challenging over time, and I think the integration has been more difficult than people probably gave credit to. I know both these guys, Randy and Mike, have basically come back and say, "holy (expletive)." I've been spending more time on this than I am on like when we owned it 100%. And I think that just -- and to say I think the same is true with the sort of partner level people at Clayton Dubilier as well. Now that said, I think if you went back and look sort of 6 months ago, I think there we're basically weekly meetings of senior Scotts people and senior CD&R people. I think people are much more chill now that things are back sort of under control. That doesn't means they are out-of-control, but I think there were some personal changes that the group made to improve the team. I think there was a lot of pressure on the team to sort of plan out and start to execute. And we talk about that a lot, at least, in my staff meetings. And I think they basically no drama on plan is a really good place for us to be, and I think I am positive that the CD&R people are staying at the same thing. Now back to the second part of the question, which is, "so now what?" So I just want to reemphasize, I am really happy we own 1/3 of this, call it, newco, because I think it's pretty much King Kong in space. And it's on plan and a lot less sort of gray hair being created probably at both places over it. We have a Board meeting Thursday and Friday of this week, and one of the subject matters is to start briefing up the Board on where do we want to go with this business. And I think it's one where I don't want to get ahead of my Board, and that doesn't mean I'm not communicating clearly with you all. What it means is that, I think there's going to be a choice. I think as this business becomes more and more where people wanted it to be, I think Clayton Dubilier, who's owned it for a long time, is going to start saying, "Okay, we got to figure out what our exit is," and Scott has to figure out where -- how we participate in that. Do we stay or do we go with Clayton Dubilier meaning to monetize. And I don't think we know that answer yet. I think it depends on what the other opportunities are. We really like the space. And I think that if we weren't challenged to look at our own capital structure, and that doesn't mean it's an issue, it means that as we look in Hydro and when we look at other opportunities we have, we will -- this I know, we will look at this LawnService business, say, a little bit like Europe. Are we better staying in as sort of the big shareholder as Clayton Dubilier exits assuming it's an IPO? Or would we rather reinvest that money or just change our capital structure and have fewer shares? I don't think we know yet. Mike and I have been pretty, I think, positive what we call pipe. Remember, everybody who uses TruGreen is a Scotts Miracle-Gro customer. And you go in their garage, if somebody who's doing a premium service that costs, I don't know, 10x more than what it cost to do it yourself, in their garage, you're going to see all the stuff that we sell to homeowners. And so our ability to have a direct line with consumers -- Mike and I have always kind of fantasized about it, we call it pipeline. That, that pipeline, that direct sales to our consumer, that sort of not exactly Amazon, but to some extent, the ability to have that direct relationship with consumers, who were already buying our products, we -- it kind of makes us a little dizzy. Now that said, we've got a lot of work to do to figure out what our biases are and what the opportunities are besides that. And so I would say standby for words, but I do think that CD&R has signaled that it's not a forever thing. And we've then said, we got to start that discussion with our Board and ourselves to figure out where we're going. So I would assume that we'll have kind of a point of view in the next 6 months or so about where -- whether we want to exit or whether we want to stay in. But I would say, so standby for words, good question.

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

Okay. And I have to get one in for Randy, if I can. A couple of housekeeping. Is it fair to say that you've reaffirmed, just want to make sure you've reaffirmed, the top line or at least the point-of-sale guidance for the year as well as the earnings per share guidance of $4.10 to $4.30 X the dilution from the international sale?

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Yes, we have not come up with a plan whether it's top line or bottom line at this point. And when we close the deal at that point, I think it's appropriate to adjust our guidance. But at this point, we still have several weeks ahead of us before we get through everything.

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

And is there any point of view, I know it's early, but you did reference commodities for '18, at least that you've locked, I think, 30% of your urea needs. Do you have any initial point of view on how you think commodity costs will trend in '18 relative to the current year?

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Sure. So John, if you go back to last year, we thought we know our benefit from commodities was in that $0.15 to $0.20 range for the year. This year, it's more about $0.10 a share. And as we look ahead to next year, we're thinking it's actually -- the benefit we're going to have this year of $10 million or $0.10, it will probably turn around for about the same level. So it should be a slight headwind next year. Not so much on urea. But again, as we look especially at peat, look at some of the cheap varieties, resin is kind of up and down and fuel is a wildcard as well. But at this point, that's our internal plan assumption for next year is the $10 million benefit we get this year will probably be offset next year.

Operator

And we'll go next to Jim Barrett with CL King & Associates.

James Richard Barrett - *CL King & Associates, Inc., Research Division - MD*

Randy, a question for you. Will the cash from the sale of Europe/Australia be held offshore? And who absorbs or maintains the defined benefit pension plan liability internationally?

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

Yes. So the deal is structured in euros. And eventually, we'll get the cash back here to the U.S. structured largely as an asset deal. It's a stock deal in some of the smaller countries. But U.K., France, Germany, it's an asset deal. As far as the pension liabilities, the pension in France will go with the buyer. We're going to maintain the U.K. pension plan and the German pension plan as well. So that's part of the arrangement from day 1 as we talked to exponent, the buyer. And we're comfortable with that.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

But I would say, they are not grossly funded.

Thomas Randal Coleman - *The Scotts Miracle-Gro Company - CFO and EVP*

No, on actuary basis, U.K. plan is practically 100% funded like 90%, 95% actuary funded.

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

I think, if there was retroactive relief on taxes, which is not factored into our, what we talked to guys about, there could be some benefit.

James Richard Barrett - *CL King & Associates, Inc., Research Division - MD*

Okay. And Jim, quick question for you. Competition for new hydroponic deals. Have other deep-pocketed players gotten smart to the opportunity in hydroponics seeing more competition?

James S. Hagedorn - *The Scotts Miracle-Gro Company - Chairman and CEO*

Yes. I mean, yes. Private equity. So we're seeing -- I don't think it's disruptive. I'm not sure we've seen competition for deals that we have been engaged in. Like we've said, I know I keep -- Randy said you're going to get to this line in the sand thing. I've had this line in the sand, I believe in it. I am not coming off it, even though I keep backing up in my line. It's not because there's new deals. Many of these deals are just taking a little longer, there's family issues, sometimes there's divorces that you're dealing with and people are just trying to sort of deal with their own personal financial planning as we do this stuff. So it's just taken sort of longer. So a lot of the deals we're involved with have -- we've been involved in for, call it, a year of sort of step-by-step going through it. I do think that we are aware that there is private equity interest in the space at this point. So I would say probably more competitive on a go-forward basis on future deals that aren't already grounded in sort of months and months of work where everybody is pretty committed to them.

Operator

And with no further questions in the queue, I'd like to turn the conference back over to Mr. King for any additional or closing remarks.

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

All right, Dana. Again, thanks everybody for joining us this morning. As a reminder, our next public comments will be on June 13, when Randy and I will be at the William Blair Conference in Chicago. In the meantime, if anybody has questions for me, feel free to call directly at (937) 578-5622. Thanks for joining, everybody, and have a great day. Thanks.

Operator

Again, that does conclude today's presentation. We thank you for your participation.
