S&P Global
Market Intelligence

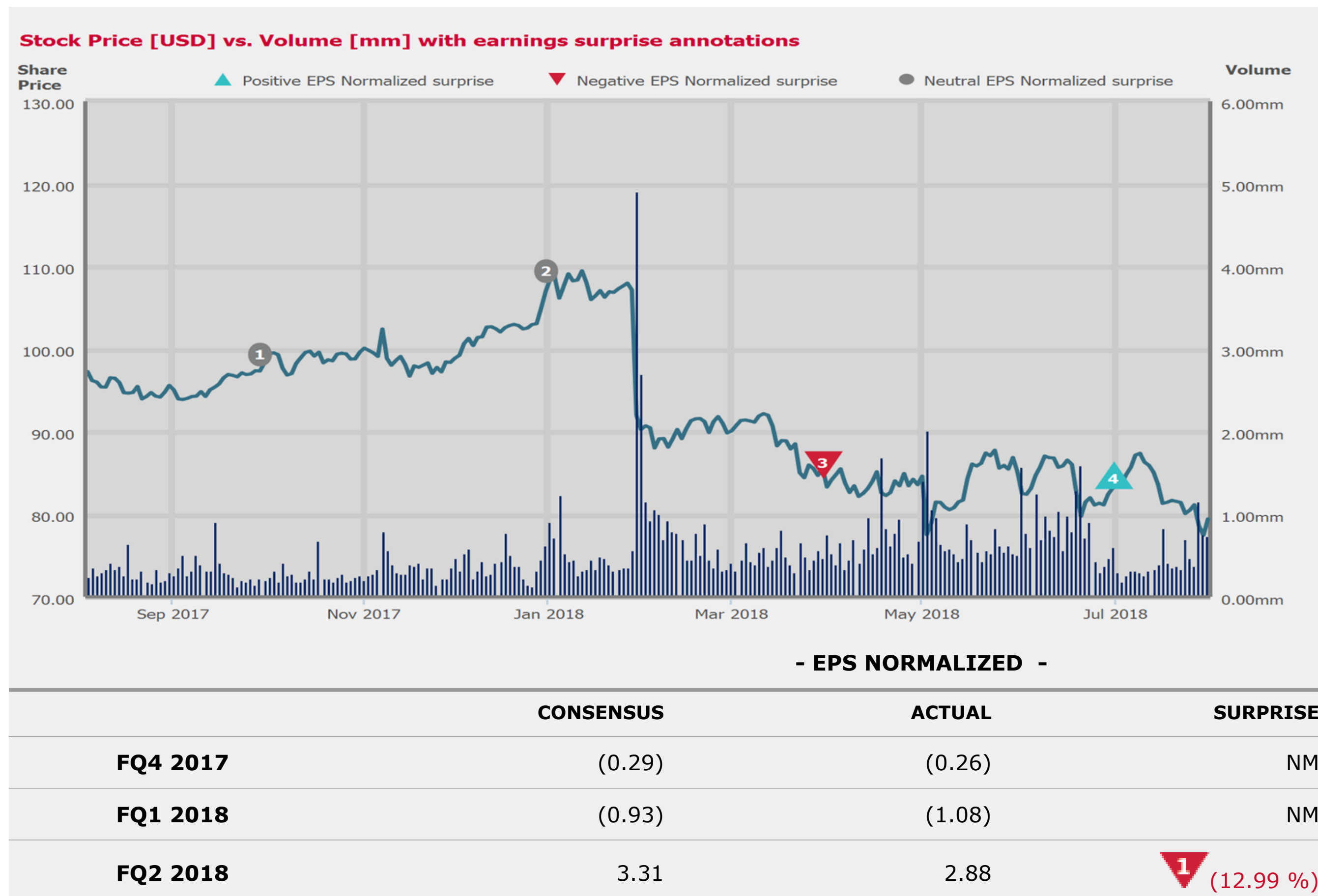
# The Scotts Miracle-Gro Company
# NYSE:SMG
# FQ4 2018 Earnings Call Transcripts

## Wednesday, November 07, 2018 2:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ4 2018- | | | -FQ1 2019- | -FY 2018- | | | -FY 2019- |
|---|---|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS |
| **EPS Normalized** | (0.66) | (0.75) | NM | (1.27) | 3.77 | 3.71 | ▼(1.59 %) | 4.31 |
| **Revenue (mm)** | 441.10 | 433.90 | ▼(1.63 %) | 287.96 | 2667.15 | 2663.40 | ▼(0.14 %) | 2968.75 |

Currency: USD
Consensus as of Nov-07-2018 1:44 PM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ4 2017** | (0.29) | (0.26) | NM |
| **FQ1 2018** | (0.93) | (1.08) | NM |
| **FQ2 2018** | 3.31 | 2.88 | ▼1 (12.99 %) |

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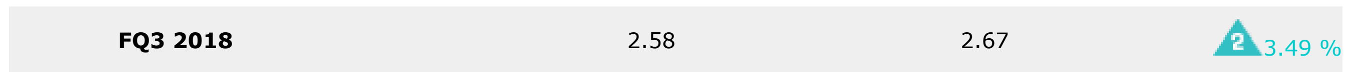

| | | | |
|---|---|---|---|
| **FQ3 2018** | 2.58 | 2.67 | ▲3.49 % |

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# Presentation

**Operator**

Good day, and welcome to the 2018 Fourth Quarter Earnings Call. Today's conference is being recorded.

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

**Jim King**
*Chief Communications Officer and Senior VP of Investor Relations & Corporate Affairs*

Thank you, Michelle. Good morning, everyone, and thanks for joining to discuss our fourth quarter and year-end conference call. With me here in Marysville, Ohio this morning is Jim Hagedorn, our Chairman and CEO; Randy Coleman, our Chief Financial Officer; Mike Lukemire, and President and COO; as well as several other members of the management team.

We'll get started in a moment with prepared remarks from Jim and Randy. Afterward, we will open the call to your questions. [Operator Instructions]

One bit of housekeeping before we move forward. Next Tuesday, November 13, Randy and I will be participating in the Morgan Stanley Global Consumer & Retail Conference at the Crowne Plaza, Times Square, New York. We'll be participating in a webcast Q&A session at 8:00 a.m. that day. However, there's no formal presentation associated with this conference, so there will be no materials related to the event that are posted on our website.

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

I also want to remind everyone that today's call is being recorded, and an archived version of the call will be available later today on our website.

With that, let's get things started. And I'll turn things over to Jim Hagedorn.

**James S. Hagedorn**
*Chairman & CEO*

Thanks, Jim. Good morning, everyone. I'll get right to the point. I'm glad that fiscal 2018 is behind us. In fact, it's probably not been since 2012 that I've been as relieved as I was this year to turn the page. But I have a much different mindset today than I did back then. That year, our performance ultimately led us down a path to adjust our strategy and to reconfigure the company.

I see 2018 through a far different lens. The result of our reconfiguration has left us with a stronger portfolio. Categories like hydroponics, rodenticide and live goods have far better long-term growth potential even if some of them took a step backwards last year. Additionally, today, we're a company with better margin and cash flow potential, metrics that ultimately drive shareholder value. The factors that impacted us in 2018 were mostly external and mostly beyond our control and have done nothing to diminish my confidence in our overall strategy.

But confidence is one thing. Results are another. So I'm not going to sit here and make excuses all morning. We understand the job ahead of us, and that's to execute, to make up lost ground and to drive better outcome for our shareholders, our associates and all of our stakeholders.

As we enter fiscal 2019, we have a lot of things working in our favor. In the United States Consumer business, we have innovation on our side next year with new organic products in both the gardening and weed control categories. We also were successful in getting price increases where we were seeking to cover commodity and distribution inflation as well as higher planned investments in people and brands.

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Additionally, our line reviews were successful, and we expect strong support of our brands again next year by our retail partners in all channels for trade.

In Hawthorne, the integration with Sunlight is on schedule, and we expect to achieve 100% of the synergies we've discussed in the past. We remain optimistic that Hawthorne will return to growth in the months ahead, and both the social and political environment continues to improve. Just yesterday, Utah, Missouri and Michigan voted to broaden authorized cannabis use. Additionally, we believe the change of leadership in the United States House of Representatives enhances the likelihood for more compromised federal legislation that will make it easier for companies to navigate the cannabis market in states where its production, sale and use has become legal.

To a greater degree than most of you probably realize, we've been a leading voice at all levels of government in shaping policy discussions. At the federal level in particular, I'm confident in saying that our engagement has helped sway opinions in both political parties, and we look forward to continuing our dialogue with the incoming house leadership team.

From a financial perspective, we're confident we can get our earnings back on track in 2019. We will also continue to improve our working capital management with the goal of another strong year of cash flow performance. I'll come back to all these points in a few moments. But first, let me put a wrap on 2018.

I want to start by recognizing the efforts of the entire team in our U.S. Consumer business. We finished the year with consumer purchases of our products flat on a year-over-year basis at our top 4 retailers. That alone was a big win given the delay we saw across the nearly the entire country at the start of the lawn and garden season.

In the home center and hardware channels combined, POS increased by nearly 3%. As you may recall, POS for the entire U.S. business was down 15% in mid-April. When the weather finally broke, the lawn and garden season also broke and it broke hard. We went on a 6-week midseason tear across all categories that was unprecedented. By the end of the year, we had positive POS numbers in branded fertilizer, grass seed, soils, mulch, live goods and rodenticides.

Once again, innovation made a big difference. Our lawns category enjoyed the best innovation year in more than a decade due to success of the Scotts Turf Builder Triple Action products as well as Turf Builder Thick'R. As a result, our branded fertilizer business increased nearly 2% this year despite the slow start to the early part of the season.

We also maintained our aggregate market share. I know some of you have been asking questions about the battle against private label, so let me address the issue head on. Private label has always been our primary competitor in key categories like lawn fertilizer and growing media. This is nothing new. Neither is the fact that we're winning.

Investors often ask why we've been able to compete effectively against private label. There are 2 primary reasons. First, in a category where performance is critical, our products outperform the private label. We know that and so do our consumers. That's why continued innovation matters so much in this space.

Second, because of our strong relationship with consumers, our brand drives foot traffic into stores. We know that and so do our retail partners. That's why we continue to invest heavily in both advertising and trade programs.

Before I move on to discuss Hawthorne, I know many of you have questions about Roundup and the implications of the San Francisco jury verdict during the quarter. Here's what you need to know. First, I want to stress that we are committed to the Roundup brand and the consumer Roundup business. We also continue to believe fully that glyphosate containing Roundup-branded products are safe for consumers when used as directed. The body of science evaluating the active ingredient, glyphosate, is immense and that scientific record supports its safety. That's why U.S. EPA and major regulatory agencies around the world have approved its use.

If I felt any different, then we would not continue to serve as Bayer's marketing agent for consumer Roundup. Our relationship with Bayer since the Monsanto transaction closed has been a productive one.

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We respect their role as the owner of the brand and they respect our understanding of the consumer marketplace.

Second, it's obvious that the scientific evidence supporting glyphosate safety has not prevented Bayer from facing a groundswell of litigation. I also want you to note the litigation issues are theirs, not ours. And we are indemnified for any glyphosate litigation in our role as their marketing agent.

Third, consumer purchases of Roundup since the verdict have actually been positive. We acknowledge that sales in this period may not be fully representative as it covers the time of the year where consumers aren't buying a lot of weed killers. Still, we're carefully monitoring consumer sentiment for brand reputation or other signs of headwinds.

Fourth, in the event the Roundup brand reputation or performance would see a significant decline, our agreements provide for potential remedies.

And fifth, the diversity of our product offering serves us well. To the extent that negative publicity might discourage certain consumers, we have other options available under our own brands in the nonselective weed control category. I don't want to provide too many details this morning other than to say we're introducing our own Ortho ground clear nonselective weed control product. This is a product that is certified for use in organic gardens and does an outstanding job, especially on patios, sidewalks and driveways. We have the only U.S. EPA registration for the ready-to-use application of this product.

It's worth stressing that we could have introduced older synthetic chemicals, but we like the idea of further expanding our organic product line. Our consumer data tells us that a nonselective weed control product that has an organic certification will have a great deal of appeal and will be a welcome complement to the existing nonselective products and actually expand the category.

With that, let me switch gears and address the most recent results of Hawthorne as well as some encouraging signs we've seen of late. Overall sales increased 65% in the quarter. Obviously, most of that growth was driven by the Sunlight deal. However, AeroGrow grew more than 50% and our European professional horticulture business increased by more than 30%. North American hydro business was down approximately 30% when making certain adjustments to create an apples-to-apples comparison, but there are some underlying facts here that are encouraging.

First of all, the overall rate of decline has improved. When we make the same adjustments to Q3, the decline was nearly 40%. Randy will elaborate on this point in a few minutes.

Second, remember that the fourth quarter of 2017 for Hawthorne included an extremely difficult comp of more than 30%.

Third, the average daily shipments we've seen over the past several months has been steadily improving. If those trends continue, we should start seeing positive growth again in the new calendar year.

Fourth, we've made solid progress over the past several months as our business and customer base continues to evolve. We've upgraded our sales force and put a more intense focus on Canada than ever before.

And fifth, the integration of Sunlight is on plan, and we expect to see 100% of our expected synergies to materialize by the end of fiscal 2019.

I don't want to suggest we've totally turned the corner because we still have work to do. There is a strong possibility the December quarter will also show negative top line results. But based on the current trends, we currently believe we'll be back in positive territory sometime during the March quarter, which is our Q2.

In discussing Hawthorne, I want to briefly revisit comments I made during our previous call. During the Q&A session, I referred to the team as gun shy. Some of you interpreted those comments to suggest a lack of confidence in the team and in the business. Rest assured, that's not the case.

Here's what I was getting at. After unexpected declines in the first half of 2018, we asked the team for an updated plan for the second half of the year. Those forecasts also missed the mark. This was frustrating

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for all of us and I know our shareholders were frustrated as well. The team reacted the same way I would have. They became even more conservative in their planning assumptions over the past several months. Their confidence in the business is unaffected and the same goes for me, but overpromising at this stage of the game just doesn't help anyone. But that doesn't mean we're sitting back and just waiting for a recovery to come to us. We're getting after it and hard.

Since our last call, we've made further organizational leadership changes at Hawthorne, primarily in sales, marketing and strategic planning. Additionally, Chris Hagedorn and several of his direct reports are now based in Ohio, not New York or Portland. This allows them to more fully and easily leverage the assets of the entire organization, whether it's marketing, legal, HR, finance, supply chain or Mike Lukemire or myself.

I want to reiterate my confidence in this team, the portfolio we've built and the opportunities that lie ahead of us for this business. While the market was clearly softer than we expected in 2018, we still made great progress. Our product portfolio got stronger, so did our supply chain, so did our data systems and so did the team.

I'd just remind everyone that it was only a year ago when we were seeing organic volume growth of more than 30%. We've talked several times on these calls about the overproduction of cannabis in the West Coast and the resulting pressure on legally authorized production. Several media reports have since validated our remarks. We've also talked about the undue regulatory burden that took effect in California at the beginning of the year. There is no doubt the hydro market has been reset going into 2019. We can't do anything about that.

You probably noticed in our press release that we took a $95 million noncash impairment charge in the quarter based on Hawthorne valuation. I'll elaborate on this later, but it's essentially a mass-driven exercise that starts with how we performed in 2018. Obviously, we're far from our original target and it will take longer to reach the overall level of profitability we assumed when we purchased the businesses.

That said, I would challenge any of you to name another company in the hydroponics space that's better positioned than Hawthorne. Yes, the market is changing faster than we and others expected, but that actually works to our benefit.

Our use of language in the past may have led to confusion on this point, so let me clear some things up. When we use the word hobbyist, we are not simply referring people to grow cannabis for their own personal consumption. That's actually a tiny portion of the overall marketplace. Our use of the term mostly refers to small professional growers who happen to buy their growing equipment in retail channels. Now, are those small professional growers facing stiffer competition from larger growers? Yes. But it's just another kind of professional grower. What's unique about Hawthorne is that we're the only player in this space that is fully able to meet the needs of all growers. Our challenge is pretty straightforward at this point. It's all about execution. As we look into 2019 for Hawthorne, in addition to the Sunlight, we expect organic sales of hydro products to increase in the mid-single-digits. We expect strong gross margin improvement and overall segment profit of roughly $60 million.

Before I turn things over to Randy, I want to come full circle and talk about the U.S. Consumer business and our outlook for next year. You'll see that our guidance assumes sales growth of 1% to 2% in the segment. Embedded in that number is 3 points of pricing on a consolidated basis, which includes increases to some categories as high as 5% and others flat.

We're also expecting strong results for Miracle-Gro Performance Organics, our new line of organic plant food and grown media products. We believe this is the first organic product line that delivers performance on par with synthetic products. I believe Performance Organics is the most important new product we've created in years and has the potential to transform the gardening industry category and bring new consumers into the space.

While we have several things driving the U.S. Consumer business next year, we also expect the gap between consumer POS and our sell into the retainer. Let me help you understand the offsets.

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First, due to the way the Roundup agency agreement is structured, profits from that relationship will be lower next year by $20 million. This should not be a surprise to anyone. Those of you who understand the accounting for Roundup also know that the profit from that business flows through the sales line. So even if actual sales of the product are flat, the impact on the top line will be a negative $20 million. That said, because of the current uncertainties about the upcoming season, we've engaged a Bayer team about this structure and we've encouraged so far by their response.

We also entered the year cautiously optimistic about the potential for improvement in the mass retail channel. I recently had the benefit of a top-to-top meeting at one of the major players in this channel. We're both aligned in our commitment to drive improved performance in 2019 for the mutual benefit of both of our companies and the consumer.

Does that mean we expect growth out of this channel in 2019? I hope so. At a minimum, I believe we'll find ourselves in a situation where we're working more collaboratively and finding more ways to win. So I see this as a good sign.

With all of the puts and takes, we expect consumer POS growth of 3% to 5% next year on like-for-like products. So the underlying health of our consumers and their support of our brands remains solid.

We're done looking back on the challenges we've seen over the past year. In fact, in the closing months of 2018, we proactively dealt with pending litigation, questions about impairment and other subjective nonoperating issues that we could simply get behind us. We did this because I want our focus in 2019 to be only on one thing, looking forward; by getting our business back on track that we've been traveling and rebuilding our credibility with all of you. I believe we've taken a thoughtful and conservative approach to our guidance in 2019 and Randy can give you more insights on that shortly.

But when it comes to running the business, Mike and the operating team are pushing hard. We are aggressively protecting our margins in the face of higher costs. We are bringing game-changing innovation to the marketplace, and we continue to refine the Hawthorne operating model and plan to take advantage of this quickly evolving new market opportunity.

With all this said, it would be disingenuous for me to ignore the share price and the impact our performance that it had on shareholders this year. After all, I didn't shy away from the issue a year ago when we were trading at an all-time high.

I want to remind everyone listening that my family is the largest shareholder, so I'm no happier than any of you. But I'm committed and look forward to having a more positive story to share with all of you in 2019.

With that, let me turn things over to Randy.

**Thomas Randal Coleman**
*Executive VP & CFO*

Thank you, Jim, and good morning, everyone. Jim H has already covered a lot of important ground and the results we announced today are pretty much in line with the updated guidance we provided in June. So my plan is to explain some of the nuances around our Q4 and full year results and then discuss our 2019 guidance. So let's move on.

The top line results in the U.S. Consumer segment for both Q4 and the full year are consistent with our guidance. There were no material changes in the performance of the business during the quarter, so I won't dwell.

Jim already dissected the Hawthorne numbers but I do want to add some color here. AeroGrow's results were slightly better than we expected. The base is not huge so it's easy to get a big percentage gain. We're also extremely pleased with our European professional horticulture process, which is almost exclusively lighting. Remember, both the Gavita and Agrolux brands started in Europe and remain extremely popular with growers in several key markets. These 2 positives helped to offset the continued softness within the U.S. hydroponics business. Jim mentioned an approximate 30% decline in the U.S.

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hydroponic sales on an apples-to-apples basis. This is an area where understanding the approach we took to the Sunlight transaction is helpful.

You may recall we said that market disruptions after the deal could lead to about $0.10 of additional dilution. What we weren't saying publicly at that time, for competitive reasons, is that we intended to end Hawthorne sales to other distributors. Those distributors were sitting on Hawthorne inventory after we stopped selling to them and they moved aggressively to sell our products to retailers. We expected that to happen and knew we would likely lose some sales in the near term as a result.

As a reminder, we guided to a $0.30 to $0.40 dilution in 2010 from the deal and our actual results landed in the middle of that range. We also previously outlined a $0.60 to $0.80 EPS increase for Hawthorne in 2019 and we continue to expect an increase at the lower end of this range when including interest and amortization expenses that are incremental to the company but outside segment operating income. So when you exclude all the distribution in both Q3 and Q4, you see a decline approaching 40% in Q3 and slightly more than 30% in Q4.

We've also been telling investors that we expected the consumables side of Hawthorne, mostly nutrients and growing media, to see a recovery before we saw that happen with durable products. That production -- that prediction has proven correct. While growing media and nutrients declined by about 15% in Q4, this was a significant improvement from what we saw in Q3.

I agree with Jim's assessment. There are several encouraging signs that we're starting to see Hawthorne. I also agree that it's too soon to declare a turnaround here. The December quarter is likely to show a decline as well.

Let's move on to the gross margin line. This is the one area of our revised guidance where we missed. In June, we said we expected a decline in the rate per year up to 30 basis points. As you can see, the actual decline was 360 basis points. Within the quarter, we saw a significant and unexpected margin issue develop in our Canadian professional business. This is not affiliated with Hawthorne. This issue, which is largely caused by distribution challenges, is now behind us, was the primary driver in missing guidance.

The primary drivers in the overall decline in adjusted gross margin rate for the year were higher overall distribution and commodity expenses, unfavorable fixed cost absorption and the acquisitions impact from Hawthorne and higher trade programs expense that was planned at the start of the year. We expect commodities and distribution to continue to be a headwind in 2019, but we believe our pricing actions will offset those challenges. I'll come back to this in a few minutes.

In terms of SG&A, the 6% increase in the quarter was largely driven by the Sunlight transaction. Overall, SG&A was down 2% for the year despite acquisitions. Going into the year, we did some restructuring so those benefits helped. Also, about $10 million of advertising expense was spent collaborating with retailers and, therefore, we reclassified to trade programs, which are netted against invoice sales.

In addition, annual variable compensation was about half of last year's levels but this was mostly offset by higher long-term incentive expense primarily tied to our expected cumulative free cash flow over a multiyear period. Our 2017 and 2018 performance and our confidence about the future caused us to accrue more in the current year.

On a non-GAAP basis, EPS came in on the low end of the range we set when we adjusted guidance in June, primarily because of the Canadian issue I mentioned earlier. For Q4, the non-GAAP adjusted loss was $41.6 million or $0.75 per share compared with the loss of $14.9 million or 26% -- $0.26 per share.

On a GAAP basis, the loss was $130.6 million or $2.36 per share compared with $42.3 million or $0.72 per share. GAAP income from continuing operations for the full year was $127.6 million or $2.23 per share compared with $198.3 million or $3.29 per share.

Non-GAAP adjusted earnings were $211.6 million or $3.71 per share compared with $236.9 million or $3.94 per share a year ago.

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The full year diluted share count was 57.1 million compared with 60.2 million, reflecting share repurchase activity of $328 million for the year.

Jim already mentioned the Hawthorne impairment of $95 million which is excluded from the adjusted numbers. Also excluded was an additional charge of $20 million related to a litigation matter associated with our former wild poultry business. Remember that we also took a $65 million charge in the third quarter related to the same matter. We're in the final stages of settling that case, which is a class action lawsuit and look forward to getting it behind us.

The last topic I want to reinforce is cash flow. We've said repeatedly that we consider cash flow our most important metric, and I think we proved that again in 2018. Our operating cash flow came in at $343 million, not far off of what we saw last year despite the sharp decline in earnings. No doubt the benefit from lower taxes helped. But I'm particularly pleased with our working capital management, especially inventory. Despite lower-than-expected sales in our U.S. Consumer segment, we still lowered our inventory levels in this business by $20 million. I still believe we have further room for improvement and the changes we made to our compensation programs are keeping the organization focused on this metric.

We've also talked more frequently over the last year about free cash flow productivity, which we calculate by dividing free cash flow by GAAP net income. In our press release financials, we include a reconciliation of this non-GAAP disclosure item. The ratio was 134% in 2017 and 431% in 2018, which obviously requires some explanation. The 2018 ratio is impacted by certain noncash items that reduce our GAAP net income. If we exclude our noncash impairment, restructuring and other items and the non-cash accruals for litigation matters, the productivity number is more consistent with what we saw in 2017.

Looking ahead to 2019, on an apples-to-apples comparison, the 431% in 2018 will likely fall below 100% due to the timing of expected payments for these litigation matters. However, excluding payments on the litigation matters, our goal is to have at least 100% productivity once again on operating cash flow of $290 million to $300 million and free cash flow of $220 million to $230 million.

With that, let's shift gears and talk about 2019 P&L guidance. On a company-wide basis, we're expecting 10% to 11% sales growth with 1% to 2% from consumer, about 8 points from Sunlight and another 1 point from organic operating growth.

Jim already bridged the U.S. Consumer number but I want to applaud the team for staying focused on getting the price increases we needed to offset the cost pressures we're seeing. No one expects relief in the freight market next year and every commodity we're purchasing is up over last year. The combination of these pressures is upwards of $30 million. Recall that we did not take pricing in 2018. That was a decision that hurt us when commodities and distribution expense were more unfavorable than we expected.

The pricing we're taking in 2019 will provide some improvement to the gross margin rate next year in the U.S. Consumer segment. However, we expect that improvement to be offset by the mix impact from Sunlight. So on a full year company-wide basis, we expect the rate to be about flat.

Let me also take a few moments to address tariffs. Our full year impact is currently estimated at less than $10 million after mitigation plans, and most of this amount stems from the fourth round of tariffs that largely impact our Hawthorne segment. We are planning a small price increase on certain SKUs to offset this impact.

In SG&A, there are a lot of moving pieces. The 8 incremental months of Sunlight obviously will result in higher expense, and the advertising dollars that were spent in customer trade programs in 2018 will be put back into SG&A in 2019. We're also expecting higher investments in people. Like most companies, we're starting to see wage inflation and retaining our best people in this robust economy requires us to take a look at both compensation and benefit dollars. We are also planning for higher annual bonuses in 2019 tied to expectations of much higher profitability and continued strong free cash flow.

When everything nets out, we see SG&A up 5% to 6% higher. I think that's actually a good place to land given the impact of acquisitions.

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Next year, we're also see the full year impact of the Sunlight deal on our interest expense. Our best estimate is that interest will come in somewhere between $100 million to $110 million for the full year. Our leverage ratio at the end of fiscal 2018 was 4.2x, and I would expect that ratio to only decrease slightly in 2019 before falling more dramatically in 2020 due to the back half timing of our operating cash flow and the pro forma nature of the leverage calculation, which currently already includes Hawthorne synergies.

We're guiding to an effective tax rate of 25% for 2019 and a share count of roughly 56.5 million shares. As we focus on leverage, it's unlikely we'll be repurchasing shares in 2019. If we do, I would expect it to have only a modest impact on next year's share count.

Bringing all this to the bottom line, our adjusted EPS guidance for next year is $4.10 to $4.30 per share.

Before we open the call to your questions, I want to say that I'm aligned with Jim as it relates to our job for 2019. It's all about execution. I believe our guidance represents our best estimate for 2019 based on our current thinking. We are not getting really aggressive on our growth assumptions and we're realistically thinking about some of the cost pressures we expect to see over the course of next year.

I'm also aligned with Jim H when it comes to driving value for our shareholders. I've spent a lot of time sitting across the table from dozens of former and current shareholders this year. The hard questions you ask were well deserved and we've done our best to help you understand the challenges.

I've also spent a lot of time with prospective shareholders. I agree with most of you who see SMG as a strong long-term opportunity right now. I've been here almost 20 years. I know this company and I know this team. We have a strong core business that generates significant cash flow, and Hawthorne remains an investment with great potential. And so I'm confident. But as Jim said, confidence is one thing and results are another. We've guided results and we're committed to delivering it in 2019.
With that, let me turn things back to our operator to take your questions. Thanks.

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# Question and Answer

**Operator**

[Operator Instructions] And we'll first hear from Joe Altobello with Raymond James.

**Joseph Nicholas Altobello**
*Raymond James & Associates, Inc., Research Division*

So first question, I want to go back to a comment you made this morning and also, in the release about focused inventory productivity efforts with certain key retail accounts. What does that refer to? And I guess, did you guys experience any changes in shelf space in light of the other price increases you're taking next year?

**Thomas Randal Coleman**
*Executive VP & CFO*

Joe, I think your first question is really to 2018, and we did see a lot of inventory productivity focus from retailers, more than we've seen in prior years. So mass channel was similar to what we saw in 2017 and we largely expected that. On the home center side, I'd say there was more focus in the fourth quarter than what we've seen the year before and that was a little bit surprising compared to what we would have expected back in June. But going forward, I think that's the second part of your question. We expect to see continued focus on retailer inventories and productivity? I think they're being prudent in trying to drive the cash flows just like we are. I think they're trying to find the most productive SKUs that they can push the hardest and those are largely the brands. So I think related to our pricing, 3%, I think it's a terrific outcome. I think it's higher than our competitor set marginally, and I think it shows the strength of our brands. And I think when it comes to decisions made by retailers, they may be pruning some of their less productive SKUs next year, but I don't necessarily associate that with pricing. I think it's just a focus on being more productive, running their business better and that's the way I'd run my business as well.

**Joseph Nicholas Altobello**
*Raymond James & Associates, Inc., Research Division*

Is that across the category?

**James S. Hagedorn**
*Chairman & CEO*

Yes, I would add to that.

**Michael C. Lukemire**
*President & COO*

It depends on category, Joe. We've seen a tighter control on the controls business going to 2 brands versus 3. So there have been adjustments there and Lowes closed some stores, there's an effect there. Bosche is out of the picture. So there's a lot of things that are affecting inventory and so. So you look at that is what I'd say.

**James S. Hagedorn**
*Chairman & CEO*

Joe, I don't think it's anything to do with pricing, to be honest. Not that I'm aware of anyway.

**Thomas Randal Coleman**
*Executive VP & CFO*

And, Joe, it's Randy again. When you compare that to market share, we've maintained our market share again this year. So looking ahead to next year, I think we'll see a little bit of decline in units, which we've debated internally whether we'll see that or not. But I think it's a prudent way to go just because retailers,

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I think, will be focused on trying to drive inventories down and continue to try peel us up and that's a good ratio for them.

**Michael C. Lukemire**
*President & COO*

And there'll be adjustment for promotional strategies as well so.

**James S. Hagedorn**
*Chairman & CEO*

Joe, I would not make a big deal out of this. I think, to some extent, I don't know what's real about it or not. We know one thing, that a lot of retailers over winner with quite a bit of product. That to me, we have tried to work with retailers to sort of focus on their gross margin return on investment and that our ability to react and distribute products allows them to reduce their inventory in the off-season. I don't sense that any of them, including mass, are disinclined to invest in the season when it really matters. I think actually, quite the opposite. So I think -- I don't know what it all means. I know one thing. Everybody was really happy how this year ended given how agreement looked in mid-April, and I think it probably affects their psychology when it comes to inventory. But it's I think as Randy said. It's not a bad thing. And if I were them, it's an easy way to improve your [ gimroy ], is just saying -- selling a bunch of stuff for 7 months a year and then selling sort of squat except sort of indoor but sitting on a bunch of inventory for 5 months is just a -- kind of a [ gimroy ] problem. And the fact that they're focusing on it and making sure that the off-season there, that actually works to our benefit because I don't think anybody can respond like we can.

**Thomas Randal Coleman**
*Executive VP & CFO*

So let's just say when you look at the rod of really productive conversation with our retailers over the last few weeks and I -- there's just a lot of energy and excitement about next year and maybe -- and internally, we're feeling really good. We just had our annual sales conference just a few weeks ago and I'd say the team is ready to go and get after in '19.

**Michael C. Lukemire**
*President & COO*

Yes, and we're optimistic, though and we're not allowed to share that so.

**Joseph Nicholas Altobello**
*Raymond James & Associates, Inc., Research Division*

It's really hard to follow that up, but -- so in terms of how Consumer sales -- just help me with the math there. Sales, up 1% to 2%. Pricing gets to 3. The Roundup agreement is a negative 1%. So you should be talking about volumes being kind of flat to down 1% next year with the price elasticity and with the potential inventory reductions that we sell practically?

**Thomas Randal Coleman**
*Executive VP & CFO*

I'd say that encapsulates it well. I'd also say that related to elasticity, our products are purchased frequently, the consumers don't really have price point in their minds. So we haven't seen tremendous elasticity over time other than the year if you go back almost 10 years ago when we took a 30% price increase on lawn fertilizers. There was a lot of elasticity at that point. But year-to-year, when we're talking about mid-single-digit price increases, we're not really concerned about elasticity coming out of that.

**James S. Hagedorn**
*Chairman & CEO*

I'd put it sort of the opposite, Joe. We're more concerned about our gross margin line eroding than we are about sort of what I would say is very slightly. And so I totally agree with what Randy said, is that on sort of once or twice per year purchase products when you're dealing with 3%, I just - in this environment

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where freight alone, I think, we look at and said freight is up 20% in 2 years with us. And basically, our raws are up. We got these taxes from bringing some s*** in from Asia, I just think it's one of those things where that was more important to us, I think, than this sort of minor fear. And I think people who aren't taking pricing right now, they're just eroding their P&L and I don't see them benefiting from it, and I see the strength that we have by maintaining the sort of quality of our earnings as actually being more important.

**Operator**

And next, we move to Bill Chappell with SunTrust.

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

Just I'm trying to make it more simple on the earnings guidance for next year. You did $3.70 in EPS. You're saying $0.60 to $0.80 from Hawthorne synergies, so in the low end of that $0.60. So that gets me to $4.30. I think I'm doing my math right. So does that just imply the core business is a negative 10 to a negative -- to get to the midpoint and a negative 20 to the low point?

**Thomas Randal Coleman**
*Executive VP & CFO*

Yes, that's the math. Though I'd say $0.60 is our estimate now for Hawthorne for next year rather than 60 days, so let's call it 60 and with the Roundup commission moving backgrounds, even with 3% pricing, we have more commodity headwinds, distribution, we don't expect that to be turned around anytime soon. We talked earlier in the last couple of calls about labor inflation that we're seeing. That's going up more in the gross margin rate and less in SG&A than what we would have modeled if you go back 6 months ago. But when you factor in all those headwinds and net that against pricing, your math is right where it is right now.

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

And just to understand. I think you said that you didn't price for variable comp going into next year but you believe you can earn that. I mean, does that -- do you have -- by having the core business at negative you can still learn a variable comp?

**Thomas Randal Coleman**
*Executive VP & CFO*

At this point, if we were to hit the midpoint of our range, we'd actually be paying out below target next year, Bill. So yes, we will be higher year-over-year but it won't be back to target levels and we expect to try to beat that number. But I think where we're at right now and early November, I think very appropriate guidance to provide.

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

And then on early November -- and I understand that. I understand we're a few months away. On the comments on the hydro business, as we're looking -- I understand you're thinking the December quarter will still be down. Are you seeing it flip as we move into November where it's actually growing on a monthly basis?

**Jim King**
*Chief Communications Officer and Senior VP of Investor Relations & Corporate Affairs*

Yes, I'm going to -- for the first time, we're introducing [indiscernible]

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

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[indiscernible]

**Jim King**
*Chief Communications Officer and Senior VP of Investor Relations & Corporate Affairs*

No, no, I'm actually not going to answer it. I'm going to give it to Chris Hagedorn to answer it.

**Chris Hagedorn**

It's a classic, he answered himself. Hey, guys, so this is Chris. Sorry my voice is a little scratchy; I've got a cold. So the -- yes, the short answer is yes, we're starting to see some positive really encouraging results as we move into November and it's particularly when you look at the business by particular categories. We're seeing some bounce back in the U.S. kind of hydro market, which is still largely a retail market for us. As Jim made the point earlier about for hobbyists, the retail market is still serving the -- kind of what I would call smaller scale professional kind of commercial growers. But the bounce back we're seeing is encouraging not only right now for this quarter but certainly for the long-term outlook for me is we're seeing really strong results, as Jim mentioned, in our European and Russian pro hort business continues to overperform. I mean those guys are the most professional growers in the world. I mean, they're Dutch and Russian indoor growers, have been doing this for hundreds of years. The other thing that makes me feel pretty confident about this is the results we're seeing up in Canada. As Jim mentioned, we're putting an increased focus on our sales up there, on our relationships with the larger scale LPs, so this is oftentimes big publicly traded guys like Canopy or Aurora, very large professional companies. The progress that we've made with the increased focus up there, establishing top-to-top relationships as well as dealing with the guys that are actually growing these plants, we're seeing really encouraging results. We've over delivered there. Sort of the early results yet for this fiscal year, obviously, but again, the numbers that are rolling in are better than we expected and that makes me pretty confident for the future here in the U.S. as well. As we look at Canada largely as kind of a proxy for what America will be whenever we see larger-scale legalization. And last night was a good night for us in terms of legalization. I feel pretty confident that we can win in that structure because we're winning in that environment right now up in Canada.

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

That's helpful. And I guess the last just follow-up on that. Is California stable as a market? Or is it still year-over-year decline?

**Chris Hagedorn**

California is beginning to stabilize. Our outlook for this year is positive for California but it's not particularly explosive. I mean, we're looking at -- can I share what we're looking at? Yes, we're looking at 2% year-over-year growth for California. So again, conservative, but I think we'll see that business start to stabilize and hopefully, slowly bounce back. But the real growth that we're looking at this business is Canada and then other parts of the U.S. that really haven't seen the growth that California had already seen leading into this year, so places like Northeast.

**Operator**

And next we'll move on to Chris Carey with Bank of America Merrill Lynch.

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

So just following up on that line of questioning, actually. You mentioned you're serving the retail or -- excuse me, at the retail hydroponic distribution channels. Those are the mid- to large-scale grower -- or excuse me, small to mid-scale grower. So how exactly do you serve the larger-scale grower? Because you are still precluded from dealing directly with that consumer, are you not? And then do you not have that same constraint in Canada because it's federally legal?

**Thomas Randal Coleman**

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*Executive VP & CFO*

So, Chris, let me start with Canada. We don't have the same kind of constraints because of the federal legalization in Canada, so much easier to do business there, And we're making a lot of progress there over the last few months particularly. When it comes to the U.S., yes, we have to be extremely careful due to legal issues, due to banking concerns and how we go the business. So while we can talk to certain growers, we can't sell to them directly, and we have to bill through third parties or through our existing retailers. So that's how we're going to business, so we can still develop relationships. What we can't do is sell or ship to them directly. But we're seeing a lot of progress like Chris pointed out, and I think we're starting to turn probably not this quarter but looking out over the balance of 2019, we do think things are going to start getting better.

**James S. Hagedorn**
*Chairman & CEO*

Look, I would say that from -- we have been really careful with sort of making sure the lawyers, both our external and internal lawyer, plus our treasury group and finance in general are involved in our sort of go-to-market strategies for the U.S. They presented a plan to me that I saw this week that puts together a group of sort of third-party resellers that is sort of our way to sort of provide insulation to that. And I know Randy is going to be talking to our banks and taking them through that plan as well. But I'd put it up as sort of required but I'd put it in the sort of frictional loss category of why the rules in this country need to be fixed and start with Congress. And I don't expect our sort of banks to lead into this. I do expect the Congress to lead into this, and I think the results last night were really important for that. And while I'm not a big supporter of the Democratic Party in general, I think when it comes to our issues in the House, you've already seen with Cory Gardner, senator from Colorado, what he calls the states act, which I think is fairly well supported within the Senate. It just didn't get a lot of traction on the House side to push it forward. I think that's over. And I think within that, you'll probably see a move to include reform on the banking side or selling where -- in states where it's legal, and so I'm very confident of that. In the interim, we'll develop insulation that satisfies the lawyers and the bankers. But hopefully, we can move through like Canada where it's a much more direct relationship in time.

**Thomas Randal Coleman**
*Executive VP & CFO*

And the other thing, Chris, I'd point out is the great, great majority of our sales still go to a retailer. And our retail partners have been terrific. It's been a challenging time for us but a challenging time for retail as well. Retailers are sticking with us. The legacy businesses that we purchased going back 3-plus years ago, the relationships we had are strong and then the business that we acquire with someone like supply, strong retailer relationships as well. So that's really where we shift to today. And I think we need to say thanks to all the people that have stuck with us.

**Chris Hagedorn**

Yes. So I totally agree with what Jim and Randy said. This is Chris again. Hey, Chris. So just to reiterate that last point that Randy made. Look, the reality is, the marketplace is evolving in the way that these larger-scale, more professional growers are going to get their products, it's going to continue to evolve as well. But my hope and our hope here and what we've been working hard with, with our retail partners is to help the retail evolve along with us and the grower. In the future, I think there's definitely a place for retail but just like the rest of us, retail is going to have to evolve along with the rest of the marketplace. So we are trying to help and encourage our retailers to do that. We've seen a lot of them really happily kind of join us on that journey. So hoping that continues but it's good so far.

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

Okay, got it. So California, plus 2. Obviously, that would imply other markets growing faster. It strikes me that Canada still has a ton of production capacity that they're building out. You have the Canadian LPs also looking at Europe. So I guess I'm trying to reconcile all that with the confidence on Hawthorne turning positive in the back half of the year, next year or the fiscal year anyways. I mean, are there specific

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opportunities or projects that you have in mind? Or is this more about kind of a stabilization effort? You have contracts with the growers that are building out in Canada, for example. Anything like that you can provide a little bit of incremental color on is this the turn that you expect?

**Thomas Randal Coleman**
*Executive VP & CFO*

Sure Chris. So like you pointed out, there's still a lot of opportunity in Canada. We're getting after that much more. We've actually co-op-ed some of our existing salespeople in our Canadian business to start becoming salespeople for Hawthorne. So we're seeing success from that right now. We're not expecting a tremendous rebound right now in California or the West Coast. We think a lot of the growth will come out of Florida, East Coast and some of these new states. And again, we're trying to be conservative on California, saying plus 2. I think inevitably, the entire market should come back to levels that we saw 18 months ago, but we're not planning for that for next year until we start seeing positive quarters. And I think once we start seeing positive quarters and get the momentum back, the margins will improve, evaluation will improve and everything will work out fine.

**James S. Hagedorn**
*Chairman & CEO*

Yes, just to add to that. A little bit more detail on what Randy what saying. So some of the states that we're looking at where we expect to see some pretty positive results for this year are some of the more -- what I would consider more unexpected states. Everyone knows Michigan. We had a really good result there in the vote last night, so Michigan should be big for us; we're counting on that. Oklahoma is a pretty explosive growth state for us at this point. A lot of new retails opening up, so a lot of volumes move through that state. Florida as well. So I think we're seeing a lot of activity in newer states that are coming online. The expectation's again that the Northeast will explode starting with -- everyone expects New Jersey will kind of lead the charge on that.

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

Got it. And then just one kind of final like I guess modeling question or -- in a way. Did I hear that you expect POS of 3 to 5 U.S. Consumer next year? And if so, it feels like that's maybe a bit ahead of where you had been talking on that business in the 2 to 4. So if you could talk to why you have like incrementally positive expectations there.

**Thomas Randal Coleman**
*Executive VP & CFO*

Sure. So, Chris, the 3% pricing in a way have that baked in that 3% to 5% number, so same units going out the doors, with 3% pricing plus units. We do think, though, on a shipments basis, units will be back a little bit just because of the retailer productivity conversation that we had previously. So that'll put a little drag on shipments. But POS is how the retailers measure their business and we think that's going to be really positive next year.

**Chris Hagedorn**

And innovation, innovation's good. So the performance organics, second year of Thick'R and Turf Builder.

**Thomas Randal Coleman**
*Executive VP & CFO*

The new ground to the line.

**Chris Hagedorn**

The new ground to the line, so we have lots of opportunity.

**Operator**

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And next we'll move to Eric Bosshard with Cleveland Research and Company.

**Eric Bosshard**
*Cleveland Research Company*

A couple of things. First of all, curious if you could, I guess, Chris, perhaps you're the right guy to answer the question, the customer mix of Hawthorne today, I understand it's been helpful to hear you characterize what the market looks like and what a hobbyist looks like, but what does your customer mix look like today within the business?

**Chris Hagedorn**

Customer mix between large-scale retail or -- excuse me, large-scale; commercial very small scale? I mean can you be a little more specific with the question?

**Eric Bosshard**
*Cleveland Research Company*

Yes. I don't know enough to characterize between the hobbyist and retail and direct to pro. You probably know the segments better than me. So how do you think about your customer mix?

**Chris Hagedorn**

Yes. So look, the vast majority of our business is, as we said in some of the previous questions, still goes through retail. It's a difficult question to really put a too fine a point on as the grower base continues to evolve. I would say from a -- if you look at these growers professional versus hobby, what I would consider hobbyist, which is people growing for their own consumption, it's probably 95%-plus professional growers. Up in Canada, obviously, those are extremely large-scale, large staffs of people, hundreds of thousands of square feet of growing space. Here in the U.S., it really varies state-to-state. I'm not sure if that helps to answer your question at all.

**Eric Bosshard**
*Cleveland Research Company*

And your mix, is that the market you just spoke to or is that your -- is that the Hawthorne mix?

**Chris Hagedorn**

It's really both. I think our customer mix is pretty indicative of the grower base overall.

**James S. Hagedorn**
*Chairman & CEO*

Just getting to Eric's question. The shift toward larger growers sort of coming out of sort of more investment, kind of professional investment in the space, do you see that shifting?

**Chris Hagedorn**

Absolutely, yes. It's definitely a shift from -- look, I would say we've been selling to professional growers this entire time. The businesses that we've acquired were selling to professional growers long before we owned them. But those smaller-scale growers and we've -- I think we've kind of hid from the world black market for a long time, but reams of these were smaller-scale professional black-market growers growing at a basement or a garage. A lot of those guys are graduating now to becoming what I would call larger-scale sort of more mature professional growers who were growing in greenhouses or largely indoor setups. So that evolution has taken place, and that's the one that I think has happened a little bit more quickly than we or anyone else, frankly, in the industry had anticipated. We'll give them competences. We are -- we've grown up at ScottsMiracle-Gro with a professional business, serving a professional customer. It's something we understand pretty well. We still have a lot of people on our staff, folks we've brought back into Hawthorne who were with Scott' professional business prior. So it's been a transition that's taken place, a little bit more rapidly than we anticipated, but I still am certain that we are the best position to take advantage of it.

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**Eric Bosshard**
*Cleveland Research Company*

Within that, I guess, to follow up that your market share with professionals in your core business is lower than with DIY customers in the traditional lawn and garden business. Within the cannabis business, within the hydro business, do you have a competitive advantage or disadvantage to have more success with the pro customer? Again, I know it's an evolving market but if you could compare and contrast the 2.

**Chris Hagedorn**

Yes, I'm glad you asked. Because the answer absolutely is we absolutely have an advantage there. The way to look at this and say, look, there is no one in our space who has the breadth of whether it's product offering, knowledge, service, sort of operational maturity that we have. There are folks that are entering -- I've heard people speculating and saying do the large-scale growers care about brand? The answer is yes. They are growing a very valuable crop. What they care about is their ability to remain profitable and operate efficiently. And the products that we sell and the brands that we sell are built upon that reliability and that consistency. Outside of that, there are horticulture and agriculture distributors who I'm sure are and will continue to make pushes into this space. What they don't have that we do is a knowledge of this particular plant. It's not hard to grow a cannabis plant. It's really hard to grow a good cannabis plant. And it's especially hard to grow a good cannabis plant consistently harvest after harvest, year in, year out. That's what we can bring people. And it's the ability to look at not just a nutrient or a light or a grown media product, but look at all of those products in -- sort of in an ecosystem and understand how they affect each other. From an innovation perspective, a product development perspective, no one has that perspective that we do. So that, I think, is a pretty significant competitive advantage for us.

**Eric Bosshard**
*Cleveland Research Company*

Okay. And then 2 other shorter questions. The organic growth assumption for Hawthorne, it sounds like you're talking about 5% in '19. What should we think about normalized growth? Obviously, '19 is a transition year. What normalized organic growth should this portfolio be able to generate from a medium-term perspective?

**Thomas Randal Coleman**
*Executive VP & CFO*

Yes, so when we look beyond '19, we look more at end consumer demand and what that model would look like over time. So we know penetration or per capita usage is increasing 5%, 6%, 7% annually. We know on top of that, the shift from outdoor growing somewhat to it's going to be almost exclusively indoor, unless you're talking about the West Coast, is a tailwind for us. We know that the mix of products and concentrated products or other edibles require more product as well. So I think all those tailwinds should get us, in the long run, midterm, long run, back into a number that we could easily tuck ourselves into double digits again. Just for 2019, until we start seeing positive quarters, we're not going to lead you down that road but our long-term thinking is that's exactly where it is.

**Eric Bosshard**
*Cleveland Research Company*

Okay. and then lastly, I was a bit confused. You talked about -- it sounded like you said an upside longer-term variable comp payout, and I'm interested in how you contrast that with the write-off within Hawthorne. Those 2 seem to be in opposition.

**Thomas Randal Coleman**
*Executive VP & CFO*

There is really no relation one to the other. So we established a 5-year long-term incentive plan a couple of years ago. It's 2/3 based on cumulative free cash flow over a 5-year period and 1/3 based on total shareholder return proxy, more or less. Through 2 years, we're doing well on free cash flow. We're not doing very well on the TSR proxy. But as we look out for the next 3 years and determine what we should

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accrue, we've had a positive first couple of years on cash flow, even though this year was a challenge on earnings. And given our focus and our plans and we expect that cash flow focus to continue and we're excited about the future and we think our P&L will rebound again and 2019 will be a down-payment on that, so that's the way the plan is constructed.

**James S. Hagedorn**
*Chairman & CEO*

It does sort of get caught in the cry. I sort of understand that. But what I try to do is view this as a positive as opposed to a negative because if we don't turn stuff around, it isn't going to pay out for squat, okay? So -- but it's when you're actually putting money into it and from an accounting point of view, it is based on our basically projections of free cash flow and driving value back into the business. So what it says is that our forward view is consistent with a above-average payout in that plan, in spite of the fact if you look at today and say, dude, really? And I get that. But it is based on our -- pretty seriously on our cash flow forecast going forward. And I've said many times on these calls that I think that the ultimate driver of the value for business is sort of excess free cash. It is something that we've done okay on. And really better than okay. But I think we've got to do a lot better and that's one of the reasons we did Hawthorne, was to do that. So I think the accounting exercise of sort of charging the account, call it, for our future thing, it's just the math that the finance group is doing, saying, if you think this is true, there's going to be an above-target payout and we've got to charge for that. So that's what it means. So I wouldn't -- instead of looking at this and saying, "What the heck?" I think -- notice that I didn't use a bad word there -- what the heck, the -- it really says something about the -- our view of the future, which is positive.

**Thomas Randal Coleman**
*Executive VP & CFO*

And our cash flow is very much driven by our U.S. Consumer core business, with EBITDA of $500 million or so, right now, Hawthorne is 10% or so of that. So that's what's driving our productivity on the long-term plan. Again, our TSR return this year is suffering because of Hawthorne and back to your question about impairment, but that's the way the plan is constructed. I think we're running our core well and we expect Hawthorne will turn around as well.

**Operator**

And our final question today will come from David Stratton with Great Lakes Review.

**David Michael Stratton**
*Great Lakes Review*

Really quick back to the core business, you talked about your private label being your primary competitors. And is there any opportunity or do you already have some of your products as private labels? Or would you be able to move into private labels as an offering?

**Thomas Randal Coleman**
*Executive VP & CFO*

Sure, David. So right now, we do probably 2/3 or maybe 75% of the total category of private label if you look across the whole landscape in lawn and garden. I think there is probably an opportunity to do more going forward. Every retailer has its own way of going about private label and how do they choose who they select as a vendor and how they merchandise their products and that may evolve and it's evolved a lot in the short run and within mass within the last couple of years. But again, if you look at the last 10 years or 5 years or 3 years, we've maintained share, actually grown share versus private label. And the only place that we've lost has just been the last 2 years with one particular retailer. And we don't think that's a consumer-driven situation at all. It's simply a merchandising decision and we haven't seen that drip over into any other customers at this point.

**James S. Hagedorn**
*Chairman & CEO*

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But we're happy to make private label for people and we are doing that.

**Chris Hagedorn**

Yes, I would go further which is we know private label is an important part of sort of the profit stream of -- and if you look at over time, at least in lawn and garden where we participate, it's probably 60% of the dollars are on the branded side and about probably 50% of the units are private label and that's been pretty consistent over the years if you look at it. I know there are some retailers who think Scotts is already sort of big enough, why should we put more? And I'll tell you why, if a retailer is listening right now. Nobody has got the footprint we have to private label. And I don't think there's anybody who can beat our price who's a legitimate player. And so I challenge any retailer to talk to us about using our footprint, our manufacturing and supply chain footprint for their benefit and deliver everything together on 1 truckload and no one else can do that. And so I make that offer and challenge to all retailers who we aren't already doing business with and say I can help you make more money.

**David Michael Stratton**
*Great Lakes Review*

Okay, great. And then I guess to kind of segue that same question over to the Hawthorne business. I think, Chris, you mentioned that cannabis is certainly easy to grow but difficult to grow well, which is your competitive advantage against the more horticultural businesses. But I think that horticultural people would say that's true for all plants. A lot plants are easy to grow but difficult to grow well. And is there potential there to get your products into the more horticulturally based businesses as a private label to expand your market?

**Chris Hagedorn**

Absolutely. We've been looking at cannabis. It's a huge opportunity and one that we are focused on pretty singularly at the moment. But our long-term plan here is, look, we want to take in as much advantage of the -- this past year notwithstanding the sloth in growth that we've seen. But long term, this business got a lot technology allow us to enter sort of the food supply side of things on what I would like to see on a global scale. So the answer is yes. I think we're learning how to grow plants in a really high-performance method here that not a lot of other people have had the margin to sort of allow them the luxury of. The hope is long-term is we can bring costs out of our products. We can apply those techniques and products to the broader food market on a global scale. So the answer is yes.

**James S. Hagedorn**
*Chairman & CEO*

But I'd also hope, just to sort of talking strategy out loud here, that Hawthorne will be open to, on retailer brands, participating on the private label as well and offering your sort of manufacturing footprint to the benefit of other resellers.

**Chris Hagedorn**

Yes.

**Operator**

And that will conclude today's question-and-answer session. At this time, I would like to turn the call back over to Mr. Jim King for any additional or closing remarks.

**Jim King**
*Chief Communications Officer and Senior VP of Investor Relations & Corporate Affairs*

All right. Thank you, Rochelle. If we didn't get to anybody today or if there are follow-up questions, feel free to call me directly. I'm at (937) 578-5622. Also, as a reminder, Randy and I will be on a webcast Q&A event on Tuesday morning. You'll be able to find a link to that session on our Investor Relations website that morning.

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Other than that, we're all wrapped up this morning, so thanks for joining us, and we'll talk to you again soon.

**Operator**

And that will conclude today's call. We thank you for your participation.

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