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SMG.N - Q1 2025 Scotts Miracle-Gro Co Earnings Call

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OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Brad Chelton *Scotts Miracle-Gro Co - Vice President, Corporate Controller*

James Hagedorn *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

Mark Scheiwer *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

Nathan Baxter *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Christopher Hagedorn *Scotts Miracle-Gro Co - Division President*

CONFERENCE CALL PARTICIPANTS

Christopher Carey *Wells Fargo Securities - Analyst*

William Chappell *Truist Securities - Analyst*

Jon Andersen *William Blair & Co., LLC - Analyst*

Eric Bossard *Cleveland Research Company - Analyst*

Nate Baxter

Jonathan Matuszewski *Jefferies - Analyst*

PRESENTATION

Brad Chelton - *Scotts Miracle-Gro Co - Vice President, Corporate Controller*

Good morning. I'm Brad Chelton, and I would like to welcome you to the Scotts Miracle-Gro first-quarter earnings conference call. I have recently stepped in to lead Investor Relations after 17 years at Scotts in a variety of finance leadership roles. I am grateful to succeed Aimee DeLuca, who will retire from Scotts Miracle-Gro at the end of this month after a 23-year career at the company. I've appreciated the opportunity to meet many of you already, and I look forward to meeting all of you over the coming months.

Speaking today are Chairman and CEO, Jim Hagedorn; and Interim Chief Financial Officer and Chief Accounting Officer; Mark Scheiwer. Jim will provide a business update, followed by Mark with a review of our financial results. Following the webcast, President and Chief Operating Officer, Nate Baxter; and Executive Vice President and Chief of Staff, Chris Hagedorn, will join Jim and Mark for an audio-only Q&A session.

To listen to the Q&A, simply remain on this webcast. To participate, please join by the audio link shared in our press release. As always, today's session will be recorded. An archived version will be published on our website at investor.scotts.com. For further discussion after the call, please e-mail or call me directly.

Now I'm going to turn it over to a special guest that Jim has invited to provide commentary regarding safe harbor and forward-looking statements.

Unidentified Participant

What up, what up, SMG Investor? It's me, that mouse that was killed in the Tomcat commercial. Awkward. Mi amigo, Jim Hagedorn, the big cheese of Scotts Miracle-Gro, asked me to be here to help introduce this Q1 fiscal earnings call. This whole thing is a little off brand for me, but I am a versatile rodent. So today, I'm going to be super profession.

During today's review, the company will make forward-looking statements and discuss certain non-GAAP financial measures. Please be aware that the actual results could differ materially from what is shared today. Please refer to the company's Form 10-K filed with the SEC for details of the full range of risk factors that could impact the results.

I don't know what any of that means. So I'm going to turn it over to Jim. Yes, my man. This is going to be lit.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

Good morning. I hope you enjoy the mouse's intro to our call. I'll begin with how pleased I am with our first-quarter results. We're off to a very good start. We delivered on the metrics that form the foundation of our fiscal '25 plan, and we feel very comfortable with our Q2 sales load-in as retailers prepare for the lawn and garden season.

They are just as bullish, if not more, on this year's season. All of this gives us great confidence in our fiscal '25 EBITDA guidance and our outlook through fiscal '27. Mark will walk through the financials as I want to discuss how we're building the company for the future.

I've often said we're on a journey. And this one began when we emerged from COVID under severe financial constraints and we're forced into crisis management. We've restored the financial stability of the company, and we're set for growth and continued progress. This journey gave us an opportunity to reflect on the future of Scotts Miracle-Gro and what we want our company to be.

In the Air Force, we'd say change often results from a significant emotional event, and that's what happened to us. We're at an inflection point where we're making changes to transform our organization. Let me tell you where we're going, what it means, and how we'll get there. All of our transformation work starts with our core convictions. Many years ago, we developed these core convictions to guide our associates in driving, protecting, and nurturing our very special and unique consumer business.

Everyone in our company carries the core convictions on their employee badge, but we've fallen into the habit of not paying much attention to them. Our future is about bringing them to the forefront again and doubling down on our consumer franchise. We are further evolving into a consumer marketing powerhouse with competitive advantages that exceed what we already have today. We're narrowing our focus and optimizing our franchise, investing in it. This is our mission.

And we have a new leadership team that's aligned to it and is driving that change. Accomplishing this mission will have a significant and positive impact on our future financials. It will enable us to consistently do the following four things: one, deliver sustained sales growth of at least 3% annually that is built on higher-margin products and innovation across all channels within our consumer business; two, be the lowest cost manufacturer of high-performance products, giving us flexibility and pricing discussions with retailers and the ability to provide both differentiated and affordable solutions for our consumers; three, drive gross margin up to 35% with mid- to high single-digit EBITDA percent growth; and four, generate strong free cash flow for more shareholder-friendly actions.

These include a long-term commitment to significantly reduce our share count and potentially issuing special dividends down the road. There is a simple answer to why these things are achievable. Our consumer franchise is unmatched and in a category with substantial growth potential. From a demographic point of view, we have a tailwind. Homeownership is as important as ever. And there's a shift happening where millennials are becoming the largest group needing and buying homes. This younger generation is our emerging consumer.

Our advantage over our competitors are our superpowers, our brands, supply chain, in-store sales force, our relationship with the largest home and garden retailers in North America, R&D, and our ability to generate significant cash flow. Our marketing is our jet fuel. We also have the most engaging creative, whether it's the Tomcat mouse you just met, to Icon Martha Stewart or actor, Kristofer Hivju, at the center of our campaigns, and they bring our brands to life. And when we integrate our advertising with our retailer programs, we drive foot traffic and in-store consumer activation at unprecedented levels. This stuff works.

We also operate within an environment where very few retailers play. Lawn and garden is absolutely essential to these retailers, representing about a fifth of their total sales and roughly 40% of their spring foot traffic. Our ability to bring consumers into their stores is critical to their success. They rely on us, and we rely on them, and we work together to drive consumer takeaway. It would be hard for anybody to build a franchise like ours.

Now let me give you examples of the investments we're making to strengthen our franchise to gain market share, bring new consumers into our world and deliver growth. This year, we're putting an additional \$40 million into our business, from brand support to innovation, the vast majority

of it going to advertising. We're expanding our demographic reach to a broader consumer base. This includes the Hispanic population, which is a growing influence in lawn and garden. We'll launch bilingual advertising on digital media and mainstream Spanish television in conjunction with our traditional campaigns. At the same time, we're spending more on consumer activation programs run by our retailers.

These programs represent a sizable annual investment in excess of 10% of our net sales. When you combine these retailer programs with what we're investing in our own advertising and brand support, that total investment nears 20% of sales.

This might sound like a lot, and it is, and we're going to continue to spend even more here in over the years going forward. Let me tell you why. In exchange for our investments, retailers give us more listings, share of shelf and off-shelf displays. For every dollar we give them to promote our products, they spend even more in activation and promotion of our brands.

The impact of our integrated efforts are evident in the nearly 10% POS lift we had last year. We outperformed the category by three times, even more if you include live goods. We'll see growth again in these areas this year. It started in Q1 with double-digit POS increases and material share gains.

You may wonder how we can afford all this and make our numbers. This is where transformation comes in, and it begins with being the lowest cost, high-performance manufacturer. This will require us to take out cost and drive more efficiencies. At a time when pricing is hard to get, and rightly so given today's state of the consumer, our ability to reduce our cost structure and realize operational savings is more important than ever.

We're being relentless in scrutinizing our organization with an eye towards optimization and savings. We're experienced at this. Our multiyear Project Springboard initiative yielded \$400 million in annual savings, of which we put \$100 million back into the business for growth.

In fiscal '25, we'll take at least \$75 million out of our supply chain. That's half of the \$150 million in supply chain costs that we've targeted by fiscal '27. I've asked Nate to get another \$30 million in savings in other aspects of our company by eliminating anything that doesn't add value. Cross-functional work streams are examining processes for streamlining and simplification. I want to stress that we will balance cost out with key infrastructure investments in things like technology and automation. To this end, our CapEx will increase by \$25 million to \$100 million this year. We're also building innovation road maps that are 5 to 10 years out.

Nate and his team are challenging the status quo to simplify and modernize the portfolio with a priority focus on higher-margin products. The Scotch fertilizer business is an example. It's a high-margin business, and we're the market leader, but our unit volume and that of the category have declined for more than a decade. Some of this is our doing. We know our pricing has got out of whack, and we've complicated things by getting away from the annual multistep solutions. We and our retail partners heaved up in the spring with big events on single bag solutions. This year, we're shifting back to educating consumers on the value of fertilizing multiple times a year.

Climate change is also making spring weather more volatile, which impacts our lawn fertilizer business more than any other. So we'll spread our lawn spend throughout the year and put more into the fall when the weather window is more favorable and open. From a product perspective, Nate's team, supported by our strategy group, is developing a strategy for longer-term success. Among the things we're exploring are new formulations, natural fertilizers and liquids.

When we think about growth, we're more committed than ever to channel expansion. A whole group of consumers buys only online, and a lot of them are new to our category. We have a team dedicated to maximizing our POS this year on all retailer e-comm sites. We're underpenetrated here, and we aim to turbocharge POS at the retailer.com channel.

In parallel, the consumer team is reimagining our consumer-facing digital assets with the launch of a refreshed Scotts Miracle-Gro brand website by year end. It will position us as a house of brands with direct-to-consumer functionality. Direct-to-consumer is our chance to expand our subscription and our loyalty programs. With this reinvigorated focus on our business, we're getting back to basics. And that raises a question: what about our cannabis investments?

We believe that moving Hawthorne out of Scotts Miracle-Gro is better for everyone. For our shareholders, this would eliminate the volatility of the cannabis sector and generate a significant uplift in gross margin. We and our banks think it would make it more clear what our equity represents and could expand our price-to-earnings multiple.

Moving Hawthorne Gardening into a dedicated marijuana business would bring tax benefits and credit capacity to that company. It would also allow the plant-touching business to work alongside Hawthorne's world-class management team with formal relationships to Scotts Miracle-Gro. I know you've heard us talk about the separation before, and you may recall that we moved off of it last year because we couldn't find a suitable partner. The difference today is there are more promising opportunities. Hawthorne is now in a position of strength after the hard work to return it to profitability. The timing is right, and we believe we can make the ship while still meeting our 2025 guidance.

I want to talk about another aspect of transformation. We've completely remade the management team, and it's led to new approaches and ideas. [Shira] is the most recent addition, and his integration has been seamless. He's taken a collaborative approach to working with Nate, Chris, and the rest of the team. And just this week, we're poised to continue with a refresh of our Board of Directors. Tom Kelly, a long-time director, has announced that he will retire from our Board effective January 31. Tom has done great work for almost 20 years, and he'll certainly be missed. I want to thank him for his service.

Later this week, I plan to nominate Nick Miaritis, Chief Client Officer at VaynerMedia, as Tom's replacement. Nick has extensive consumer brand and digital marketing experience. Nick's appointment would continue our efforts to bring new skills and perspectives to the Board, along with more diversity in terms of age, ethnicity, gender and sexual orientation.

In the past three years, we've added five Board members with expertise in leveraged finance, fast-moving consumer goods, retail, market-leading brands, growth strategies, general management and C-suite level leadership. These changes reflect where we're headed, giving us the skill sets that align with the strategy that I've described today.

Good things are happening at SMG. We're driving growth and margin recovery. We continue to improve our financials. We're strengthening the most powerful franchise in lawn and garden. Scotts is an iconic American company with a rich history of market-leading brands spanning nearly 160 years. We built this category that has extraordinary financial upside, and we're continuing to re-define it. For our shareholders, this translates into greater value creation and sustainable growth.

My management team and I are completely committed to this. I want to thank our retail partners, our banks, my leadership team and our associates for their commitment. Most of all, I appreciate our shareholders for sticking with us and supporting us as we take our business to the next level.

Now I'll turn it over to Mark.

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

Thank you, Jim, and hello, everyone. Before I get into the first-quarter financials, I'll add to Jim's comments about the transition and how well it's going.

Throughout my 13-year career with Scotts Miracle-Gro, I've worked in many facets of finance, [forged] strong relationships with our external partners and collaborated with the executive team and business leads. I'm a believer in being open and transparent, and I look forward to developing relationships with the investor community. I've built on this approach in my early tenure and look forward to helping the team make progress towards our fiscal '25 and three-year growth plans.

My passion for growing this business and driving value is rooted in my own lawn and gardening experiences. I'm an avid consumer, and I can personally attest that Scotts Miracle-Gro has the best brands in the business.

Shifting to the quarter, we are off to a great start. I am pleased that the strong first-quarter results are well ahead of expectations. While we're optimistic for the year, we are maintaining our guidance, especially since the first quarter represents less than 10% of our total POS.

Our second and third quarters will be the biggest contributors to our full-year performance. So you can expect us to revisit guidance later in the fiscal year, as we usually do, once the season is in full swing. What we know from our first quarter performance is that we have positive momentum and our retail partners are highly engaged. We are positioned to drive consumer takeaway with the right strategies and investments.

In addition, our first-quarter results reflect the hard work by our supply chain team in order to achieve our full-year target of \$75 million of cost savings, which, as a reminder, is a part of our \$150 million three-year target that Jim outlined earlier.

Now let's take a look at the top line. During the first quarter, sales on a company-wide basis were \$417 million, up from \$410 million. US consumer volume gains increased 11% to \$341 million from \$307 million, offsetting planned softness in Hawthorne. This included the strength of higher consumer engagement in the fall and earlier retailer load-in for the spring season. We expect retailer load-in to be the strongest in Q1 and Q2, which typically account for a little more than half of our expected full-year net sales.

Replenishment orders in Q3 and Q4 will be dependent upon the level of consumer sell-through during the peak, spring, and summer selling season. As previously shared, for the full year, we expect low single-digit core growth in US consumer sales which excludes the impact of nonrepeating fiscal '24 sales for AeroGarden and bulk seed and fertilizer raw materials. POS is another healthy story with an increase of 12% in dollars and 13% in units. Consumer takeaway was driven by our fall advertising and promotional investment along with more positive macroeconomic factors.

Hawthorne sales declined 35% to \$52 million compared to \$80 million last year. A significant decline was expected because of the strategic shift Hawthorne made in April '24, to exit low-margin third-party distribution and focus on its more profitable proprietary brands.

For the full year, we expect mid-single-digit decline in Hawthorne sales. While Hawthorne's top line was down, its profitability improved significantly in the quarter, and we continue to expect that Hawthorne will contribute approximately \$20 million of EBITDA for the full year. Add it all up and from a full year total company perspective, we expect our full-year net sales to be around flat to prior year.

Now moving to gross margin, we achieved over 750 basis points of improvement in both GAAP and non-GAAP adjusted gross margin rates. The GAAP rate was 22.7% versus 15.2% in prior year. And the non-GAAP adjusted gross margin rate was 24% versus 13.7%. The primary drivers include lower material costs, favorable fixed cost leverage, improved product and segment mix and lower distribution costs from our prior year warehouse closures. As I mentioned earlier, we expect the \$75 million of supply chain savings to contribute to our near 30% gross margin rate target for the full year.

In terms of timing, about two-thirds of the fiscal '25 gross margin rate improvement will come in the first half of the year due to favorable material costs and the benefit of last year's warehouse and other facility closures. The remainder will mainly come in Q4 as we lap onetime inventory write-offs taken in the fiscal fourth quarter of last year. Total commodity needs for fiscal '25 are approximately 60% locked as of the end of the quarter. So we have high visibility on input costs through the remainder of the year. All in, we are tracking well to our full-year 30% gross margin rate target.

Moving down the P&L, SG&A was \$125 million, an increase of 9% from \$115 million a year ago. The increase was mainly driven by our planned investments in our media, technology and people. As previously shared, our year-end SG&A target includes \$40 million of additional investments in our business that Jim talked about.

Along with higher performance-based incentives, these investments will drive our current year SG&A to approximately 17% of net sales versus 16% last year. Adjusted EBITDA improved by nearly \$30 million. For the quarter, it was income of \$3.8 million versus a loss of \$25.8 million last year. This reflects our Q1 gross margin recovery coupled with strong fall POS results and higher retailer shipments ahead of spring. Below the line, interest expense was down 21% to \$34 million, on lower debt balances and more favorable interest rates.

We continue to use strong cash flow generation and working capital management to further reduce debt. We now expect interest expense for the full year to be lower by \$15 million to \$20 million versus prior year. For Q1, the non-GAAP adjusted tax rate was 31.4%, due to the impact of the seasonal pretax quarterly loss and the timing of discrete items. For the full year, the non-GAAP adjusted tax rate is still expected to be in a range of 27% to 29%.

Also, because Q1 is typically a lost quarter, given the seasonal nature of our business, the company is required to use the basic share count to calculate EPS. For the current quarter, this was \$57.3 million compared to \$56.7 million in prior year. The increase in share count is attributable to share-based compensation and is expected to increase to approximately 59 million shares on a diluted basis by fiscal year-end.

The first-quarter GAAP net loss was \$69.5 million or \$1.21 per share compared with the prior year loss of \$80.5 million or \$1.42 per share. Non-GAAP adjusted loss, which excludes impairment, restructuring and other nonrecurring items, improved significantly to \$51 million or \$0.89 per share, versus a loss of \$82.2 million or \$1.45 per share a year ago.

Now moving on to certain adjustments to our GAAP numbers. For the quarter, we had \$21.7 million in impairment, restructuring and other nonrecurring items. This activity included the following: first, employee severance costs, including those related to executive team changes; second, valuation losses from our fiscal '21 investment in RIV Capital; and third, the final phase of our Project Springboard cost reductions that began in fiscal '22.

You may recall that our Hawthorne Collective subsidiary provided an investment in the form of convertible notes to RIV Capital, which has legal cannabis operations in the state of New York. Late in our first quarter, RIV Capital merged with Cansortium. As a result, we converted those notes to nonvoting exchangeable shares in Cansortium. Going forward, these shares in Cansortium will be accounted for as an equity method investment with our proportionate share of Cansortium net profit or loss being recorded with an equity earnings line in our P&L. We plan to record this activity on a lag starting in our third quarter of this fiscal year.

Next, I'll move to free cash flow and the balance sheet. We continue to focus on free cash flow to further strengthen our balance sheet. And in Q1, our total debt was lower versus prior year by \$337 million. Free cash flow usage for the quarter of \$475 million reflects our normal seasonal build of working capital. Our strong financial results, along with the cash flow management, have helped reduce our leverage ratio another quarter turn.

For the first quarter, our leverage ratio was 4.52x net debt to adjusted EBITDA. This is well below the covenant maximum of 5.5x. Note that our covenant maximum will fall throughout the year, decreasing to 5.25 in the second quarter, 5 in the third quarter and 4.75 in the fourth quarter of this fiscal year. Our expected leverage ratio will also continue on a declining path, and we have line of sight to achieving leverage in the low 4s by fiscal year-end.

As I wrap up, I want to recap our three big financial objectives this fiscal year. They include: first, invest in our brands to maintain and build upon the sales growth in fiscal '24 from additional listings and share gains; second, drive margin recovery through sales growth and supply chain cost savings; and last, strengthen the balance sheet through further debt paydown and a focus on returning to a more flexible capital allocation strategy. We will continue to make substantial progress on each of these in '25 and remain on track to our three-year growth plan.

Lastly, we are tightly managing costs and, to echo Jim's comments, we are strengthening our core consumer franchise and what he calls our superpowers. Most importantly, we are future focused, building on greater value and creating a more shareholder-friendly environment.

Thank you, and we can now start the Q&A. I'll turn it over to the operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Chris Carey, Wells Fargo Securities.

Christopher Carey - Wells Fargo Securities - Analyst

There was a comment in the press release about strong fall season across all categories and some early retailer load-in for the spring season. Do you envision any timing shifts from the March quarter into the December quarter? Are there any implications for the March quarter, number one?

And then secondly, as we sit here going into February, can you maybe expand a bit on early reads that you're seeing in markets that -- I suppose there's no markets that are breaking, but how you're feeling across the country right now going into spring? And maybe just sprinkle in any comments on your exposure to the West Coast and Los Angeles County specifically. So just a little timing shift on the December versus March quarter than some early season reads.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

There's a lot of stuff in there, dude. Let's just start with the fall went really well. And actually, there is season happening. We're having a Board meeting in Florida where after this call we were headed down there on Thursday and Friday Board meeting there, where it's forecasted to be like near 80 I think, for, I don't know, the next five or six days.

So definitely, the country is beginning to come away from a lawn and garden point of view, and the numbers continue to look good at the POS level. Nate and I were speaking to a senior merchant, very senior merchant. I guess that was last week. What we were talking about was partially in my comments that I made today and did that sound right to them, which is sort of discussions about program dollars.

But we got into just how POS looks and their view of -- based on the business that they're seeing in the fall. And so far, the spring where markets are opening. Did they have data that sort of portends in what to look forward for. And they believe that they did, and it wasn't just lawn and garden. It was just generally their sales and that they felt that this was a good indication that the consumer is alive and well and willing to buy. This is a home improvement retailer.

So that that felt pretty good to us. Their biggest concern, and this gets to the timing, is do they have enough inventory deployed at the store level. And so what that said to us is there's no sensitivity on load issues and there's a view -- again, go back to this based on what they were seeing with their POS data, not just in lawn and garden, but across the chain -- that the consumer appears to be in a good mood to buy stuff. And that historically, that is a good sign. So I believe it, I wanted to believe it, too. So I think that's healthy.

I don't know what I've missed, Nate, on what I was --

Nathan Baxter - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

No, Yes, I'll add a little more color. So coming out of last summer, lot of lawn damage in particular. And I think the fall POS really showed the consumers were engaged. We know historically that not all consumers come back and fix in the fall. So I think that gives us a little more confidence in the spring.

Coming on the West Coast, really a nonfactor for us. We're obviously deeply concerned about what's happening in those communities. But from a business perspective, not going to be material. And of course, our teams will be out there helping folks when the time is right to rebuild. I

would add likewise, this winter weather we've had, especially in the Southeast, on the East Coast, I think the conventional wisdom among our retail partners is that will be good for lawn and garden. There will be a lot of necessary repair work in the spring. So overall, between what we saw in the fall, the load-in that's supported by our Q1 numbers from our retail partners, we feel like we're as established as we can be for a decent spring and we'll see what happens.

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

And then, Chris, just to circle back on kind of phasing of sales, the low single-digit US consumer guide that we've given you. We would expect the first half and the second half of our fiscal year to be pretty consistent as far as having that similar pattern of sales growth. So there might have been a little bit of earlier load in than maybe some of your models and all that. But I would say that generally, that low single digit, we should see that the first half of the year and then the second half of the year.

And as far as traditional sales patterns go, we've kind of gotten back to our pre-COVID norms of the 55% to 45% -- 55% of the first half of the year being sales and then the 45% in the back half. So we've gotten back to a little more normal sales pattern on that front.

Christopher Carey - Wells Fargo Securities - Analyst

Okay. Great. comprehensive. My follow-up is on Hawthorne. Jim, I think the concept of a strategic alternative for Hawthorne has been contemplated for a long while now, and there have been logistical challenges with actually getting something done, right?

And so I guess, in a way, I think there's always been some desire or increasing desire to do something with the asset over time. And so I guess the question is, are you feeling like the logistical side of actually being able to do something with the asset is getting better? Or are you simply saying you remain committed to finding an alternative for this business?

James Hagedorn - Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer

I'd say both. I think Matt and I probably were not exactly in the same spot if you look back when Matt was here. And I think his view is if it's profitable -- some of you guys shared this when you were out at the Investor Day here last summer, that -- first of all, it's good news that Hawthorne is back in the black, and that's decent for the equity just based on your PE. I would say PEs are higher in sort of our business than they are in sort of the screwed up public equities that are out there for cannabis. And therefore, it does add value. Where I got to, and so I'm leading with my chin a little bit here because this is probably the last 1.5 months where basically -- and we can talk about it during the call, but it's not that the market has been so kind to Hawthorne. It's been very much internal work to cut expenses and do everything they can to get where they get to.

And I think we're confident in the \$20 million. We have -- on my mandate they are on my board for Hawthorne. It's a bigger number than Mark is using in our strategic plan numbers, meaning that -- I think it's going to be hard work for them to get to a number that I would find respectful. It doesn't mean it's impossible and they've done really, really good work, but it means it's a relatively small beer.

And I think if you look and say, with all the sort of downsides of good news, bad news, and I think hard on the shareholders. Clarity on what our equity represents, that I was talking to some of our external advisers, and I just said, the question is, this could be so much more valuable in a pure pot business than it could be with us. This is not like we're looking to get rid of it. We're looking to sort of focus our investments in sort of the best configuration possible for our shareholders. And I'm going to say, for Chris, who really -- one of the things that Chris does here is lead that business for us. And authority matters, I think, that's my view.

And so once I made that decision, which is -- and not by myself and one of the things that we did is we sort of finalized the script here, is I wanted my entire leadership team to say, do you guys all agree? Because it's not just that I agree in a couple of our advisers. It's do you guys all agree that this is the right move. And they said, yes.

And back to now the logistical side, the logistical side was never something we couldn't do. I think we just said is it kind of worth the hassle if the decision is to keep it in there and it's positive. And remember, this is legal business. Is that the best thing. Changing, which I think helps with the profitability of the business. It's a different conversation when it's a loss-making business than when it's a stable, profitable business in which it is now.

So I think once we all agreed and I agreed that this was the direction then it was me asking people to say, break down the logistical issues. And we're going to talk about this with the Board. And I think the Board is -- I think, these things is going to be the request, is the Board is going to authorize me subject to a bunch of things that have to happen, working with the banks and stuff like that so that we do need approval from banks on this. But my view is all that's going to happen in the next couple of months, and we'll begin as soon as we can.

So you may start seeing the first steps of this because there's a bunch of different assets we're talking about. Is moving them could be as soon as a month or two. So I think we're pretty much primed for action. There's agreement amongst the leadership team. I think we've got to go through the final step with our Board to make sure they authorize it. And that Mark does this thing with the banks, they approve it just from a security point

of view, securitization point of view. And then I think you'll see us in action. So I think we're through both of those things. I think we feel like from a decision point of view, we're good, and logistical, as you called it, point of view, I think we're in motion.

Operator

Bill Chappell, Truist Securities.

William Chappell - Truist Securities - Analyst

Does have a question, I guess, specifically for Nate and for the whole management team. I mean, we [duct] over the 20-some years I've covered the company about stepping up marketing and advertising and new R&D and stuff like that to grow sales. If I look at your business, there's two ways to grow top line. One is expanding the number of regular users and, two, would be expanding the basket size or the amount they spend per year. And I'm trying to understand, is there a quantifiable opportunity on either and which one has more opportunity? And how are you going about kind of expanding it?

James Hagedorn - Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer

I'm going to jump in just at the beginning part because part of this is revisiting our core convictions and investing in the brand. Bill, I think if we look at sort of market last year, probably, I think, 3%. I think the numbers are worse [sitting in] live goods within total market. We grew at about three times that. And that was a lot of share gain in there.

And so this was coming out of a period where we kind of wanted to get the program dollars back, retailers resisted that. We talked about -- that have created probably a lot of confusion on this discussion last year. In exchange for leaving those program dollars at the levels they were at and probably actually increasing it a little bit, we picked up a lot more shelf space and promotional -- percent of promotion that occurred in the departments. And so that was really good for us, and we see that occurring pretty much at the same levels this coming year in sort of POS units.

Now it's a very fair question to say how long can I keep going, how much share is there to take. I think Nate has been very much focused on where is there additional business where we are under-penetrated. So you want to take that?

Nathan Baxter - Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President

Yes. Sure, Bill. It's a great question. And the simple headline is both are important, but let me break it down this way. I think as we go into the spring, consumers will see our focus from a messaging standpoint is on frequency.

If we look at lawn fertilizer plant food, for example, we know there's opportunity. We've gotten off message in terms of our multistep and the need to feed. So that will be a big focus this year, which we think we can increase that basket size. And we'll do some cross-brand work as well. Jim alluded to our new website, and we're working with retailers on programs where -- liquid controls. For example, we can figure out a way to attach them to some of our fertilizers.

But the user thing is important, and Jim referenced it in his opening remarks on needing to engage that next segment. If I take a step way back and just look at household penetration overall for lawn and garden, it's less than 50%. And if I look at the trends over the last decade, number of users, whether they're people stepping out of the category or new homeowners who just don't have the confidence they are engaging in the category, unfortunately, that's rising. I look at that as an opportunity.

So while we've gained share in the near term through innovation, listings and retailer programs, we've got to do more than that. We've got to talk about education. We've got to talk about engagement. And it's a big force lever. It's every 1% of household penetration is another \$50 million in

[ferts] for us, for example. But every additional one-tenth of a turn of what we call frequency or the average number of applications, that's almost an equivalent for us. So the opportunity just to some, they're both there.

In the near term, it's focused on, what I'll call, the heating frequency, and in the mid- to long term, we're absolutely focused on how to engage that consumer that we're not engaged with. And I'll add, I think there's opportunity for us in the do-it-for-me space. And I don't mean from a service standpoint right now. What I mean is getting consumers who choose to use a professional to choose our products, and that's an area that we'll be thinking about in the midterm as well.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

I don't think we should not bring up the sort of dotcom side. I think as we look at the business, and I think -- we got a whole new crew running our brands now, and they are hungry and enthusiastic and younger, and I love what they're doing.

On the control side, I think what's really clear is we're very much underpenetrated in these sort of dotcoms, whether it's the retailer.com, it's the Amazon, marketplace, call it. And what you're seeing is, weirdly, competitors actually live there. And we're very dominant in retail. We're clearly less dominant online. And that means we have to have some products that are redesigned, but a lot of it is in the controls market. And I'm talking hundreds of millions of dollars.

And so we see competitors in there. You're seeing [Procter] play a little bit with Zevo in there. And you're talking more than \$100 million and not just once a couple of times. So this is a clearly low-hanging fruit for us, but we have to go after it. And I think the young crew that's working the business under Nate and with Nate's enthusiastic support, this is a big opportunity.

And the part that may be nervous about it is when they define the opportunity, he was talking in like nearly \$1 billion of opportunity. And this gets back to your question, Bill. And I said too, seriously, vanish that number, make it a smaller number so that you don't get out of balance where we're trying to make investments and we're chasing something that's a little bit in the ether. But there's clearly a lot of upside there.

So I think that this retailer.com thing is a big deal, particularly with younger people who are very used to buying online, they're not going to brick-and-mortar sites as much. This doesn't go against it. I know that a lot of our biggest retailers are very active on dotcom and enthusiastic about us helping them. But there's a lot of opportunity there and penetration. And the screwed up part for me is we're letting people live under there, and we need to say that business should be ours. And so we're going to go after it.

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

And just real quickly, Bill, on the investment side as they've talked about that. I mean, to me, it's very much kind of folds into our superpowers. I don't foresee this being a massive amount of long-term investment. We will continue to invest as part of our longer-term plan. But things that Nate has talked about. I mean, we've got incredible supply chain facilities, incredible distribution capabilities. We have a lot of that already in stock that it should be a pretty good return on our investment. Will we have to invest? Sure, but I think it could be easily managed.

William Chappell - *Truist Securities - Analyst*

That's great. And just the follow-up. Tougher for us sometimes to see the changes in market share or whatever at the retail level during the season, we kind of hear it at the end. Is there an area of, be it lawn food, is it soils, mulch, something where you're super excited about, hey, we're really geared up, we can gain big chunks of market share and really grow faster. Or is it really kind of broad brush, we've got momentum overall.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

Okay, if you don't, we can both answer it. Because it's another one of these, I think, good question. If you look and say, where is the business? It's easy to go with the current. Controls and gardens are honking and that's good for us, okay? That's high-margin business.

I would say double digit is what we're seeing, and we expect to sort of continue. So I think that that's where you're going to see kind of share gains because that were just in the flow, and that's good news for us. We're not losing share on lawns. I think we're in a really, really, really good place. I think that everybody is now basically saying, we need unit buying back, okay.

Remember, you don't see a big decrease in dollar sales in lawns, mostly because we've been pricing. And I think we were saying we've sort of reached the limit of that, mostly for the consumer. And it's a good profitable business for us.

But I think this multistep get bags up, we've got a real plan. And when you talk -- this is the legacy business at this property in Marysville, and to have everybody basically be willing and open-minded to sort of critically looking at what's happening in the market and willing to make change, the entire team is in a really good place and very open-minded to change. And I think this is all healthy. I wouldn't do not read anything bad here. This is getting people to be kind of critical of the lawn business here. I don't know. It's like criticizing Horace Hagedorn or something. It's tough to do and get away with it.

Here, everybody is open-minded. And whether it's the brand team, supply chain, R&D, the leadership team, everybody and the Board, everybody is interested in that. So that's probably the most troubled area, but I would say it's unit volume is what I would be looking at on that. And I think that would be a good thing for you to look because it's one -- if you said to me, there's top two or three things you're working on, I would just say continued recovery, margin investment in our business, and lawns, and getting resolved, getting our Hawthorne assets all put together in a place that adds the most value. That's what I'm looking at.

Operator

Jon Andersen, William Blair.

Jon Andersen - *William Blair & Co., LLC - Analyst*

Boy, there's a lot to chew on here. I did want to say that I didn't have the mouse on my bingo card this morning.

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

You've got a bingo card. That's cool.

Jon Andersen - *William Blair & Co., LLC - Analyst*

Maybe starting on gross margin, I'd love to hear a little bit more about the cadence that you're expecting of gross margin improvement throughout 2025, but also you've kind of established this three-year goal of getting back to the mid-30s. And I think maybe, Jim, you've characterized it as that last third which would come post 2025, I believe, will be the hardest yard -- those will be the harder yards to get. And any updated thoughts on that 2027 objective and perhaps those harder yards and how you're feeling about getting back to that level?

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

Well, let me just take before Mark starts off. There's been a lot of pressure from my Board to have a longer strategic plan out view than through '27. I've resisted pretty hard largely because of exactly what you said, like first, I believe that, which is that I want to get to kind of our new spot before

we start sort of confusing ourselves with a lot of long-term objectives that I think -- not that they're not important, but I think we're not completely done fixing this business and getting it to where what I talked about.

I'm not sure that I buy that it's a lot harder because I think the team -- and I'm going to give credit to our rookie here, Shira, who's doing an absolutely fabulous job. And largely, he's just working really well with the rest of his finance team and the operating group. And so I think there's a line of sight to almost everything we're talking about here. So I don't think it's as hard as you think. I think it is going to require us to do some more hard things. But believe me when I tell you, we have line of sight to the numbers.

We're obviously pushing to a higher number than where you guys are at. And I think that's not unusual and that's, I think, what we should be doing. It's harder than you think a little bit, largely because incentive kicks in and just makes a harder number harder because the number we tell you has got the incentive already built into it. But people are pretty motivated and they're chasing it.

So I guess that's really what I would say is not so hard line of sight. Everybody is working well together to get there. There is a bunch of stuff that has to happen, but I think people are working on it. And we're trying to springload that, especially the change, what we call transformation. We're trying to get that done as early as we can just because it's hard on the organization to go through change where they don't really know what it means, it sounds scary and maybe a little bit it is, but these are choices we have to make.

And it's in part to produce the results that we all, and you, want, \$700 million of EBITDA in '27 or at least, but it's also to make the kind of investments and run the business that we want. And that is my view that we have an unbelievably unique consumer franchise. And part of where I've gotten my head to, it works for me, put it that way, is if you look at the multiples of proper consumer brand companies that are dominant in their space, whether it's Procter, Clorox, Colgate, Church and Dwight, I don't know, I could go through a bunch, what you're going to see is multiple expansion that's pretty significant compared to where we are.

And where we are, we're probably lucky it's not worse given the journey we've been on. So we want that, and we know we can get that. It does mean we've got to look at ourselves hard and make some tough choices and we're going to. So part of it is about producing a financial result. Part of it is making the investments in the brand so that this franchise is extremely durable.

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

Jon, just a follow-up just very specific on your two questions, phasing and long term. So for phasing for this year on gross margin, so we've talked about \$75 million of cost out. We very much have line of sight to that. And as Jim said, the team is pushing to get more in the fiscal year as well. But at the end of the day, that in my prepared remarks and all that, it's about two-thirds first half of the year. That \$75 million will get put in for the fiscal year. And then the other -- a third will go through the back half of the year.

So the two-thirds, the reason it's more front loaded, obviously, is commodities. Inventory. We've done a nice job, obviously, acquiring inventory at lower prices. Year over year, we've seen the commodity, deflation. And so we're now working through that cheaper inventory to where we're now on a good level playing field for the balance of the year. So year over year, we were still working through some higher cost of inventory last year, the first half of the year. And so that's why you'll see that year-over-year benefit from the lower cost of inventory.

So I would foresee additional gross margin improvement in Q2 versus prior year. Again, about two-thirds, like I said. And then third quarter, probably pretty close, and then we'll get into Q4. In Q4, we'll begin to lap the E&O charges we took around \$29 million, which will be a year-over-year comparison benefit. So that's kind of how the phasing for this year goes.

As far as long term, I would just tell you, we were landing around 30% on a full year. If you look at the core business, it's north of that, the lawn and garden business gross margin-wise, very healthy. We are constantly doing, we call it, (inaudible) savings project activity and review, and the team is looking at that on a constant basis well out into the future. And they've already been building plans in place to deliver on the next phase of the \$150 million of supply chain savings. So that will be another \$75 million in '26 and '27.

And the timing of that, we're still finalizing, but it would come over those two years. And it's very much going to be tied to projects and activities that we're looking at. And transformation will be a part of that, but the team has it built into their core. It's what we've always done pre-COVID. We were good at getting those costs out. And I think if you go back and look at pre-COVID US consumer type margins, we were traditionally in that 35% range. So we feel confident we can get back to those as we rightsize the supply chain infrastructure.

I would say longer term, is pricing a part of that, it could be. We're going to try to be as nimble as possible around that, and that's why transformation is important to us. But I think you can see us laddering up then in getting there. Hopefully, this -- I think of '25 as a downpayment to how we get to the mid 30% range. And I think the first-quarter results kind of show that. So hopefully, it gives you a little bit extra confidence.

But Nate, do you have anything else?

Nathan Baxter - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Yes, not to belabor it, but I think a few details, Jon. So I've got my business units looking at three main things. First of all, Jim referenced in simplification. I guess, we'll call it a SKU effectiveness project. But basically, I think it's been a long time since we've taken a hard look at the margins on a SKU by SKU level. And I'm not implying we're going to massively strip the portfolio down, but I think my GMs need to know where their margins are. So that's the first piece.

Innovation. Look, innovation will drive margin accretion, and we've been trying to get that innovation engine turned back on during the pandemic. And our challenges afterwards, we were really focused on cost out. We've made some nice additions to the team to think out 5, 10 years and then, of course, the supply chain efficiencies.

And the other comment I want to make is we're not going to do this at the expense of retailer margins. They're our partners, and we're going to work with them to make sure that programs we put in place drive win-win for both of us. So it is all task, but I told Jim, he asked me, can we get to 35%, and I don't think I skipped a beat. I think we'll get there. I don't have every step in the way mapped out, but directionally, I'm pretty confident.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

I mean I'll just add, pricing will be a part of this, not all of it, but pricing will be a part of this. Remember, Hawthorne out, I'm going to say, is worth at least 100 basis points.

Operator

Eric Bossard, Cleveland Research.

Eric Bossard - *Cleveland Research Company - Analyst*

I guess to start, Nate or Jim, I'm curious, strategically, as you're thinking about price and market share and gross margin and connecting those three things. You've got commodity savings this year, which is funding some gross margin expansion. Jim, you mentioned a consumer that's price sensitive. And then you also talked about market share progress. And so I'm curious, do you feel the need as we work through this year to be more promotional to spend money to -- you talked about this innovative multistep program of being more aggressive with discounts to drive consumer traffic.

Is that part of it? And obviously, there's some more private label competition out there. Or do you feel like the investment in the brand and marketing is sufficient that you can power through all of that, which is basically what you did last year. How do you think about connecting those points?

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

Well, I think they're all connected, but I'll start there. Again, this is like my word evolution. So it doesn't mean it's where everybody else is around the table. There's a lot of people here. But I would say -- we looked, and I think we've talked about it with you guys that as we went through our most challenging years, there was a lot of incentive dollars to make sales happen when we wanted them and needed them. And the retailers did it, and they were big boys and girls, and it was all voluntary.

But I think what you saw is our margin go down and theirs go up. And now (inaudible) over and troubles over and I want my money back. That's kind of where I got to. The more I've looked at it though and the more I thought about it competitively, and this is one of the reasons I've been chatting with retailers at the senior level about it, is what we're seeing is they're working so hard to get consumers into the store that for every program dollar we put in, they're spending more than that of their money, driving our products and our brands.

And all of a sudden, I started thinking of myself if we can make our margin goals, and I don't want that money back. I just want it working hard for me. That was part of the discussion, which is I'm cool with this, but I think talking to Josh Meihls, I don't know, a couple of weeks ago, he just said we got to have very sharp elbows then, because those programs got to work, and they don't always work and sometimes they do, a lot of times they do. But that was really the discussion and the sort of journey in regard to exactly what you're asking.

What I'm seeing, Eric, is it's very virtuous. And that when you look at it that way, the investments in the brands, I'm talking our investments, at sort of activation at the store level and the money we spend behind it, you're talking north of \$700 million. And from a competitive point of view, my view is I'm in the moat building business.

I want a deep moat and keep people away from what belongs to us. And we intend to keep it. And it's not like we're seeing crazy stuff except you do have Procter kind of playing around our space, and we want to throw a party for them as well, even though it's not really -- like they're not really -- it's more SCJ with the Zevo business that they're sort of playing around. And I would say if SC Johnson is listening, we could use some money to defend against them, but we're going to put our money into defense of the controls business, not that they're really looking at our stuff, but it's got us thinking about how powerful this franchise is and how important it is that we defend it.

And if we can make our gross margin numbers work and keep that money in there, I think we continue to then have outside share. And I think that's kind of how I connect it all up. So I don't really view it as an option. I don't think we're done spending. If you are looking at my Board right now, what I have in there is a, I don't know, 25% increase from today in our marketing dollars.

So this is all -- we're not done with this work. This is the work that if I was -- we leave here [to go to a] two-day Board meeting. And I think everybody is going to come back and really get into transformation. And not only achieving the business on a day-to-day basis because we're pretty much in season at this point, but I think completing the planning that's going to be required to get where we want to get to, everybody is going to really get into it.

I think if I try to ask people today for transformation discussions that they know there's a lot of work already happening, I think they'd say, can we get to the Board meeting first. And so we're going to do that. But there very much is a correlation between all this stuff. We're not taking our foot off the gas pedal. Eric, you've been following us long enough. We've done this before. There was a year like during the financial crisis that I said, I can't really control anything. What I can show people is that we can sell more and advertise more.

Now it was pretty devastating to our P&L. Now at the time, the incentive was based on two things: ad spend, our market share in POS, okay? So it didn't even include profitability just because the world suck. And so I said we're just going to -- while the world sucks, let's just prove that advertising works. We hadn't figured out how to be able to sustain that level of spend and make the money we needed to make. That was kind of what we discovered.

The new version of that is we're going to make the money we need because we're going to go through this transformation, and we're going to spend it. It's just going to be a little bit different company when we're done. And it's going to be highly focused and pretty more like, I don't know, any --

Nathan Baxter - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

No. I second everything you say. Promotions, Eric, worked for us last year. We've leaned into it more this year. And I think the art is in sort of working from top of funnel, our media, down to consumer conversion at the shelf, and making sure along that entire path to purchase, we're spending those dollars appropriately.

So I would say as we evolve, and I have a new team here, we're spending more time thinking about, from top to bottom, how those dollars work for us. Our retail partners have been great. And just to touch on the private label, it's an important part of the business for our retailers. And of course, we support that business for them in a lot of areas. I don't see it as a threat. I see it as part of a good, better, best. And just taking a step back, if I look at private label share since 2019, it's been declining. So it's part of the equation here. I don't see it as something that's going to derail our focus on growth and margin.

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

The only other thing, Eric, I'll circle back on is margin. All of what they said drives volume, drives fixed cost leverage, it just allows us greater flexibility. It's why you're seeing that we can do what we can do on the gross margin line this fiscal year and beyond. So I think they all play nicely. The finance team here will be focused on making sure we get the proper [align] on that and margin recovery, but balance that with the longer-term vision of the company.

Eric Bossard - *Cleveland Research Company - Analyst*

Okay. And then a second question, if I could. I think you talked about that your POS was up 9% or 10% last year and up 3% market, and you sound more optimistic going to '25 than you did '24 for a whole host of reasons. Is there a reason why both those numbers can't be better in '25?

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

Well, first of all, I think every time we get in our head that we can do better, we f*** it up, to be honest. And so I think the biggest risk factor Nate has probably in his numbers is consumer takeaway. And so it's not a shy number. It might roll up to kind of low single digits, but it's not shy. Do I think we could do better, particularly if we had a good year, which would be nice, I think the answer is yes. But I think it's a little bit like Nate saying, I think there's \$1 billion of upside in all these other channels, including dotcom.

We are deeply in recovery in a good way. And I don't want to start chasing stuff that sounds good. But do I think there could be -- yes, I think yes, I do. I think the last year sucked, dude. It's like we -- why did we pick up some much? Because we have a lot more shelf space. That's fundamentally it. And I think we did a really good job on some of our marketing programs. The fall was fabulous and for a lot of reasons, right? The weather was great, lawns have been kind of burnt up.

We had just great programs put together so the consumers were seeing our product, like a lot of control stuff happening, including Tomcat. So just, it really came together. And I think that shows the power of the franchise. We just got to string it all together now. So do I think there's continued upside? I don't know if I need double digit because I think it's crazy to say that, even though maybe. I think if we can just keep this going longer, which I think is the best way for us to look at it, I think it's really good for the franchise, and it keeps people.

Look, the problem when we say more, and it's a little bit what we saw this year, and it's the criticism a little bit we got from ISS, is we had a really great year last year. It just wasn't quite as good in the EBIT line as we thought. And I think a little bit, we were kind of out of our mind when we sort of said \$600 million last year was so easy. And our incentives were based on that, just so you know. So where it really screws us up, dude, is the incentives because the incentives are pretty levered.

And so we sort of convinced ourselves, we can do something. And then we have a really good year, but not quite as good as we have and the incentive crashes. And then we got a step to the Board and say we had a great year, do you think we should make an exception? And this is a joint effort with our Board. We pay a target after last year, which was a very important recovery year for us, it just paid at 100%. It would have paid less.

That was ISS' criticism. And so we have this real deep negative leverage in our incentives that if we overpromise ourselves, everybody gets hosed. And so we got to kind of avoid that. So just throw that out for (inaudible).

Operator

William Carter, Stifel.

Unidentified Participant

This is Andrew on for William. Just wanted to ask, first off, with the kind of gross margin guidance that you gave for the year, just to understand it's got the bulk of improvement, I think, two-thirds in the first half. Then you have the fourth quarter lap, and you're kind of implying 3Q is flat, and I know you don't want to get into the granulars of it. But if I go back to 3Q of last year, that's 29.2%, which was 700 basis points below 3Q '19.

So I guess, I'm asking in your plan here, is there a lot of flexibility here for the mixed performance, particularly this is a lawns quarter and perhaps a more normalized lawn year or better performance could be upside the margin? But just anything in there as I'm digging in?

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

Yes. So we would still expect -- I think maybe I misspoke a little bit on saying it was completely flat. But it should be up a little bit. And you are right, we should have some flexibility there with our product lineup and as we progress into Q4.

Unidentified Participant

Perfect. Second question, I guess, I would ask is just to step back and level set where kind of cost savings are over the next year. Go 30% gross margins in hand. You want to go towards mid-30s, removing Hawthorne from the P&L will obviously help from that. You've got line of sight to about half of that, you said before. And then there's a, hey, go get it. And I think you also mentioned a challenge of \$30 million this morning to Nate. I assume that's incremental to the \$150 million.

And then kind of a final question is you've taken kind of all these costs out, it's clear you're putting dollars back into advertising. But as you think about the supply chain and the potential stressors on it, do you see any risk there of not being able to meet the demand, and I don't think -- I hope we'll never have a COVID again. But that was a -- fill rates were below and that really stressed. But just anything you can give on kind of driving the comfort that there's not going to be a -- get to ['28], hey, we need to reinvest this business in the supply chain.

Nate Baxter

Yes. Maybe I'll touch on the supply chain, Andrew. Good question.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

Let me just throw in there. Andrew, Chris was giving you the finger when you said get rid of Hawthorne.

Christopher Hagedorn - *Scotts Miracle-Gro Co - Division President*

It was in a good natured way, Andrew.

Nate Baxter

No. Listen, you highlight exactly something that we sort of framed as we embarked really starting more than a year ago on our supply chain transformation, which is build it with the most flexibility possible. So I am not concerned about capacity either in the short term or the mid to long term. Jim talked about the incremental \$25 million in CapEx. A lot of that is going into technology to help us be more efficient and give us the capacity we need.

I'm just proud of the team. We're down to like six distribution centers from, I think, a peak of 18 or something like that. So we are definitely making sure that we are not overcutting when it comes to those optimizations. And you'll see the investments. In fact, I'll be talking at the conference in March just about our manufacturing strategy.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

So could you just talk maybe just a second about just the crew that's down there.

Nate Baxter

Yes. So the great thing about our supply chain is led by Dave for a long time, just a lot of inherent knowledge there. But Dave's done a great job hiring and we've got some young VPs, really technology forward, that if you were at our conference in July last year, you may have met David Husky. But we've got some really smart people just completely helping us reimagine this, everything from fully automated forklifts.

Probably the biggest thing we did is this core distribution center. It's a mile down the road from our Marysville manufacturing plant. All of our fertilizers distribute out of that, and it's picked up by our retailers. We've saved, like, 0.5 million miles of truck driving over a year between distribution centers. We've got a really good crew. You'll see more coming out of us in supply chain. That \$3 million, Jim asked for, I would say the bulk of it probably comes out of supply chain, but it's all going to be based on a foundation of investing in technology, whether it's supply chain, field sales force, et cetera.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

I'd also say, Andrew, that the entire corporation is going to contribute. And that's a little bit like let people get back after Board meeting and start sharpening the pencils, but there's a lot of teams working right now. A lot of that -- it's not just Nate. Nate has been contributing. When you look at the sort of [400 out 100] back into the business, a lot of that's come from the operating side. And God bless, but that's where a lot of money gets spent. So it's not inappropriate. The corporate is going to participate here too. And we're asking real big questions about who we want to be and how we add value here.

Listen, Mark can say because he's the most important bean-counter and sort of keeping the score here. But I don't think that number is scary at all. Do you?

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

No, not at all. And I think to your point, it will come also at corporate and SG&A. And so some of it might get reinvested as Jim talked about on super power, some might drop to the bottom line. I think it just allows us some flexibility as we continue to do our '26 planning, which we already have started and have been focused on even while we're in season. So yes.

We'll all participate in that process. There's plenty of opportunity there. I think there's a lot of technology over the past five, seven years that have allowed us to do our jobs a lot easier and I think get more efficient. I think we've got some good ideas.

Operator

Jonathan Matuszewski, Jefferies.

Jonathan Matuszewski - Jefferies - Analyst

Nice results. First one was on innovation. In your prepared remarks, you referenced natural fertilizers and liquids as part of the product road map ahead. So just curious how you see those contributing to the 3% sales growth over the medium term and how you think about innovation as a contributor to US consumer segment growth ahead relative to history?

James Hagedorn - Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer

Yes. Jim, I'm going to steal the beginning of that. It's really Nate's subject matter. But here's what I would tell you. This goes back to one of my main priorities, which is seeing progress on unit volume and loans. Remember, we're not losing share. This is a category-wide issue. One of the things, I think, that's concerned by younger people on chemicals used in the yard. And so I do think that organic is one way to avoid people being sensitive. So we know how to do this. This is not hard.

So a lot of times, you believe in organic, you put it in the field, it just doesn't sell that well -- consumers. But I think that one of the reasons people don't see it is their concern of our chemicals. And so we want to make sure we're looking hard at that and so we're going to do that. Nate can speak formulation changes, except I would say it's a very tough place to innovate when you're dealing with controls. There's not that many controls.

There's not a lot of innovation in ag chemicals, to be honest. And so you tend to be using the same actives. And so I'm trying to infuse to everybody here that if this was Procter and we were talking Tide, I think they would assume the cleaning power convenience of cleaning for homemakers, all this stuff gets better over time. What world are we living in where we're sort of dealing with 30-year-old technology and thinking it's okay? EPA is trying to push us to -- because they're looking at total exposure that consumers have over a lifetime, including food they eat and their exposure to pesticides there. And so they're inhibiting the ability to put down actives as a way to mitigate lifetime what they would call risk up, which means less effectiveness.

So lack of innovation in the actives, putting down less than probably is optimal to get the controls you're looking for. And I think that drives a need for real innovation. Then I'll get to this other part, which is my view of the seasons and that I think, and I cannot -- we hire really good weather people. I cannot get a really great answer as to what we're seeing in the spring is related to climate change. I think it is because we're seeing it over and over again, which is kind of [squarely] behavior in April, which is prime for this and really open fall.

And we advertise, we stimulate business. The retailers like it too because they're in lawn and garden mode. It's their kind of spring. But what do I think? I think if you talk to a lot of researchers here, they put down in the fall, and they'll say, fall is the best time to [seed].

But we're fighting for the spring, and we're fighting for what I think is unreliable weather. Meaning that there's a lot of deviation to the forecast in the spring relative to the fall. That's what I can get out of the experts. So meaning it's -- forecast weather more frequently in the spring in April than there is in fall, particularly Midwest, Northeast. So I'm trying to push to there, and there's another thing that they do.

If consumers don't apply our products with a wet lawn, they're not going to get that grade control. They'll get good control, but not great control. And we want great control. If you talk to experts here, I don't care if it's supply chain people, people who know, supply chain people, R&D people, senior leadership, they're applying straight feeds with liquids, liquid pesticides, which gives a really good control because it gets right into the leaf. You don't have to apply it to a wet product, which we think some people -- a lot of people don't.

So that's how you're hearing kind of innovation, seasonality and promotion throughout the year as opposed to all just in the spring, trying to make the fall important, organics and liquids, because we're trying to sort of get at the things that can cause people to have less great results or make it kind of complicated or deal with bad weather. So those are why you're hearing all things. But when it comes to just innovation where Nate's going, which is he's -- look, he's not me. It's good. No, he's a very process guy who has plans for everything. And innovation is a planning exercise. It's a long-term investment exercise.

Nathan Baxter - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Yes. I mean, look, I'll break it down to sort of how we look at innovation, which is easy use for the consumer, effectiveness, value and safety. And depending on your consumer, those things, the rank order of importance changes, but I think Jim talked about it. This year, we've got our full Miracle-Gro organics line coming out. That's been a big hit in gardening and we know that that's important.

We have some new innovation in lawns coming out. We have our OM Scotts sort of our heritage line, pesticide, herbicide free, straight food, straight seeds, it's going to be in a [curve] recyclable bag. So we're playing around with the new form factors. I mean, I certainly would like to see less plastic in the world, but it's got to work. We've got an all-natural that sort of is going to compete with the P&G offering coming out this summer.

And here's the thing. I want to be able to offer to whatever the consumer wants. And if we want to have a consumer that wants to be all natural, we'll have products, but we're also going to have really smart products that are effective and safe to use that contain active ingredients. And we'll talk a little bit with consumers. This goes to the education piece, and I can't stress it enough. We can invent all the great things we want. If we don't talk to the consumer, help them understand how to use these things, it will fail.

So that's going to be a big piece of it. And then I'll just end with -- I think we're the only player in the category that has the horsepower to engage with some of our active suppliers, some of the big ag companies. I mean, we are looking 10 years out. We are looking at biologicals. We are engaging in sort of some of the crystal research they're doing looking for more natural ways to improve the performance, whether it's controls product, whether it's a fertilizer, plant food. So it will take time to build that, but it will absolutely -- as long as we stick to is it easy to use, is it effective, does it bring value, and is it safe, I'm pretty confident that we'll be leading the pack with innovation.

James Hagedorn - *Scotts Miracle-Gro Co - Chairman of the Board, President, Chief Executive Officer*

[Why don't you] announce your new partner on innovation --

Nathan Baxter - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

So Rob Candelino, outstanding new Board member. He will be taking over for Tom Kelly. My team has a lot of respect for him. He's probably given us more insights in the last few months than we've had in a long time just because he's a working CEO and he's still out there fighting the good fight. So just a really great add to the Board.

And while I'm deeply sorry to see Tom Kelly go, and I think we need to give Tom a lot of credit for where this company's been over the last couple of decades, we've got an all-new team and I'm pretty excited about that.

Jonathan Matuszewski - *Jefferies - Analyst*

That's great color. And just a quick follow-up. A lot of references to the opportunity in the dotcom channel with some of your major retail partners. Is there any way to dimensionalize kind of where you stand today in terms of penetration? And just help clarify the step for executing on that opportunity. I think it was referenced maybe some optimization of product sizes to work in that channel, but is there any?

Nathan Baxter - *Scotts Miracle-Gro Co - Chief Operating Officer, Executive Vice President*

Yes. I'll just say broadly, in DIY brick-and-mortar, on a unit basis, we're, call it, 40% market share across sort of all our categories. We're barely in the double digits when it comes to the e-comm play so a tremendous amount of opportunity.

Here's the thing. And I hate to pick on my old company, Intel, but I worked for them a long time ago, and I joined them when I thought they were the most sort of forward-looking tech company in the world. I think we all know their challenges today. One of the things that they tried to do, and I think they've learned from this is they built a perfect formula around building, designing, manufacturing, marketing and selling CDUs. And any time they try to get into adjacent businesses, they try to impose that same formula on them.

I think we have to look at it the same way. We've built a beautiful franchise around DIY, brick-and-mortar lawn and garden. We are not at all giving up on that. There is growth. But for us to operate effectively, whether it's in the e-comm or omnichannel, where you need smaller, lighter packaging, you're not going to pick up a [gown of] roundup or ortho in a grocery store, but you might pick up an easy-to-use apartment size form factor, we've got to be there. And so the team is already working on that.

The other end of it is on the Pro side. We need to be able to cost effectively provide product on large scale to engage with small and medium-sized professionals. So yes, we absolutely have to reimagine it. And my only mandate for my team is that we don't impose sort of the way we do things today on those growth opportunities.

Mark Scheiwer - *Scotts Miracle-Gro Co - Interim Chief Financial Officer and Chief Accounting Officer*

Jonathan, maybe just to dimensionalize. Just a follow up on that. You talked about around like 10% or so. It ranges single digits for some categories, slightly above into the low double digits, above 10% in other categories. So it just depends category to category. But to his point, a lot of great opportunity that we can do there, especially on the form factor and just different type of offerings and all that good stuff.

Operator

Ladies and gentlemen, that does conclude today's presentation. We thank you for your participation. You may now disconnect, and have a wonderful day.

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