The Scotts Miracle-Gro Company
NYSE:SMG
Company Conference Presentation
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EXECUTIVES

Cory T. Miller
Senior VP & Interim CFO

James D. King
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ANALYSTS

William Bates Chappell
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Presentation

William Bates Chappell
Truist Securities, Inc., Research Division

Good afternoon. This is Bill Chappell. I'm the senior equity analyst in consumer at Truist Securities, and welcome to our Truist Consumer Symposium. This afternoon, we have management of Scotts Miracle-Gro. If you don't know it, based in Marysville, Ohio, which is outside of Columbus. Scotts is the leading player in lawn and garden and hydroponic supplies. Its lawn and garden supplies are sold under the names such as Scotts, Miracle-Gro, Ortho and Roundup through a variety of retailers. In fiscal 2020, the company generated $4.1 billion of revenue, then its current market cap is roughly $12.6 billion.
Today, we have Cory Miller, Senior Vice President, Interim Chief Financial Officer; and Jim King, Senior Vice President of Corporate Communications and Investor Relations. I think I got that settled, right? And then, so why don't we just jump in?

Question and Answer

William Bates Chappell
Truist Securities, Inc., Research Division

Obviously, it's been a -- dynamic is an understatement year for the lawn and garden category. It was really like one of the bigger beneficiaries of the lockdowns and work-from-home and related restrictions. Can you -- kind of stepping back before we talk about going forward, how does the company prepare? I mean for a business that grows 2% to 3% every year, it grew 20%. So how -- from a marketing, from a manufacturing, how do you prepare for something like this, especially for a season that's only about 3 to 4 months long for the peak?

Cory T. Miller
Senior VP & Interim CFO

Well, thank you, Bill. And Jim, I'll take this, and please feel free to jump in as I'm missing something or to add color.

I'd say that going into the season a year ago, going into the season, the focus was being on being flexible and being able to change our marketing plan on a moment's notice, be on air more with a changing message versus the historic way of marketing, which was come up with a single ad campaign that you'd run and run and run over and over and over, being flexible in changing that marketing campaign more often and getting that on air for a shorter period of time, then moving to the next was the new plan. And I think that, that fit in nicely with the change that we had for this year.

We increased our digital media over that same period of time. So as TV ratings went down, we had a larger presence in our digital media ratings and a larger presence on social media and so forth. And that change helped us as well. And I'd say from a product perspective, the capacity that we had in our facilities to generate more product to get it produced, distributed and out to the customers was challenged last year. And we took -- it took all the flexibility that we had in order to get that product produced and pushed out to the retailers.

And while we tried to do as much as we could to get to the retailers, it really brought our inventory down, which is something we continue to focus on, but the flexibility that we had allowed for as much of that growth as we could handle, and we captured most of it, and we're going to continue learning from it. So it definitely wasn't perfect, but the flexibility that we put into that plan allowed for as much as that capture as we could handle.

William Bates Chappell
Truist Securities, Inc., Research Division

And so, for the lawn and garden category, I mean, would you say you left some revenue on the table? I mean, were there out of stocks or issues where it could have been even -- nothing wrong with mid-20s growth, but I mean, it sounds like it could have been even stronger.

Cory T. Miller
Senior VP & Interim CFO

Yes. Certainly unprecedented on a business that historically had single-digit growth for us to jump that far, that fast did challenge us. And we think we did leave sales on the table. In our consumer business, there's been different numbers out there, I know, reported, but probably in excess of $100 million of sales that we left on the table. And we want to make sure we're building inventory as we go throughout the 2021 season to make sure that doesn't repeat.

But that kind of growth -- like I said, everything that we had to produce and get out to the customer, we were using in a short window last year because certainly, 20% was much higher growth than what we've seen in the previous years.

William Bates Chappell
Truist Securities, Inc., Research Division

And how are you able to -- I mean, when I think like promotional programs, usually, that's a money sent to a retailer to promote and advertise, but it would seem when things are flying off the shelf, you don't need money to promote. And so how do you -- how did the overall program is affected? How are you able to pull back on those on short notice? And is that just kind of the nature of the business year in, year out?

James D. King
Chief Communications Officer & Executive VP

Well, Bill, the promotional programs vary from retailer to retailer. So they're not all the same. Sometimes those dollars will go for things like co-op advertising. Sometimes they'll go for volume rebates. They're really kind of tailored based on kind of the individual strategies of the retailers, ultimately getting back to the same price for every retailer, but the promotional programs are set up differently.

I think what's changed for us in terms of our mindset around promotions is what do we do with the incremental dollar that we have available? Do we give it and put it in retailer promotions or do we invest in marketing and brand support?

And I think where you've seen a real evolution over the last 24 months is that incremental dollar that we have available to us moving away from promotional activity -- retailer-focused promotional activity and really going to invest more heavily in brands and in the consumer relationship because we've evolved that process so much more. We think we're getting a better return on that incremental dollar by putting it there. And by the way, the retailers do, too. So that's what's really changed the most in terms of kind of our thinking around promotions or promotional dollars.

William Bates Chappell
Truist Securities, Inc., Research Division

Got it. It's safe to say, it's not as simple as things are flying off the shelf with [pet] promotions and so our gross margins skyrocket. There's a lot of stuff that's in place in [indiscernible].

James D. King
Chief Communications Officer & Executive VP

Correct.

William Bates Chappell
Truist Securities, Inc., Research Division

And then when I look, the lawn and garden categories is 50 different little subsegment categories. Were there certain ones that grew meaningfully faster than others?

James D. King
Chief Communications Officer & Executive VP

Gardening did the best last year by far. And that was mostly true in our soils business last year, which was up more than 40%. And if you look at the Bonnie business, which we last year owned 25 -- we had a 25% financial stake in Bonnie, which are edible live goods: rosemary, tomatoes, peppers, zucchini, those sorts of things that you buy at retail and then take home and plant your garden, that business was up even further last year, about 50% POS growth.

So gardening was, by far, the fastest-growing segment of the business last year. That said, we saw double-digit increases in POS in every product segment last year. Really great growth last year in the insecticide business, which you could almost draw a line back to when schools started shutting down and when people started working from home, and it was like a hockey stick in terms of the growth of POS activity in that particular business when that happened. But across the board, lawn and fertilizer had a great year. Grass seed had another great year. So we saw a good double-digit strength kind of across the board.

William Bates Chappell
Truist Securities, Inc., Research Division

And when I look, this company would say, "Well, look, everybody [indiscernible] home. They all had a freedom or victory garden," and that's now going to go back to [a lot of] nothing as they go back to school or summer vacations or what have you. And so how do you -- give us comfort that -- on that -- that some of this is [obtained with]? How do you -- or that it was more than just vegetable garden per se?

James D. King
Chief Communications Officer & Executive VP

Yes. I think it's a mistake to think about this category in kind of a one-off way. This is not like painting your living room that unless you just like torturing yourself, you're not going to paint your living room every year, right? You're going to paint it every handful of years at the most.

Gardening, once you engage, it tends to be a pretty sticky category. In most years, what our consumer data would tell us is that about 80% of people intend to come back if they were involved the previous year. So there's always kind of some movement in and out. What we're seeing going into this season is that, that number is closer to 86% or 87% of people who say they intend to come back after participating last year. More importantly, of that group of people, 65% of them say, "I intend to do more this year than I did last year."

So that's what's really giving us confidence is that consumers telling us that, "I intend to engage again. I intend to increase my activity." And that's not unusual for gardening activity. Gardening is something that once you start doing it, you're doing it. You've put a garden in your backyard, you've planted some roses and tomatoes, whatever, you tend to stay engaged in the category.

I think the retailers this year, I think the enthusiasm that you see with them getting set for the season so early and so aggressively with inventory is also a reflection of that, too. I think they're seeing the same kind of data.

William Bates Chappell
Truist Securities, Inc., Research Division

Well, and it leads me to the question like somewhere over the past 4, 5 months, the company, Scotts, went from, "We think we can retain it to -- we're going to do everything possible. Let's -- don't waste a perfectly good crisis and aggressively spend and retain."

Is that the kind of data that led to that decision? Is that the right way to think about it? Because it seems like it's kind of pivot into or lean in is probably the better way to think about it over the past few months? Is that right way to think about it? And what kind of is behind that volume?

James D. King
Chief Communications Officer & Executive VP

I think it's twofold, and Cory chime in. But I think part of it is keeping those people engaged this year, right? Obviously, we have to comp or we're going to try to comp the year that we had last year. And so we're going to have to lean in really hard with those consumers.

I'd say, though, Bill, more importantly, and I think shareholders should view it this way, that this is not necessarily an investment -- the relationship with these consumers that we're thinking about as just having a benefit in fiscal '21. This is keeping people engaged, especially millennials, who are coming in as new homeowners or recent homeowners, who are engaging in the category.

The value of keeping them in for the next 5, 10, 15 years is huge. And so engaging them now while the activity is still kind of young for them, new for them and keeping them engaged long term is worth a lot. So we're looking at it both through kind of the near-term lens of comping next year and looking at this being just a reset of the business and our new level of growth to build off of, but we need to keep those people engaged in order to do that.

Cory T. Miller
Senior VP & Interim CFO

Yes. And I'd say that engagement is with the consumer as the -- as we're messaging out to the consumer as well as the retailer, the retailers are engaged like they haven't been in the recent years. Inventory levels are up. Therefore, seeing a strong start to the season, they're loading up on inventory. They're engaged in lawn and garden. And that's exciting to watch. And they are driving their success, and we're going to continue working with them to make sure that product is there when the consumer comes in to buy the product.

And our messaging to the consumer, like Jim said, is all about driving that stickiness to the new consumers that came into the category last year. We kind of shifted our approach from 12 weeks to 12 months of marketing. And that shift means that we message out to the customers in a way that we haven't in the past, in times of year that we haven't in the past to make sure that we're kind of always on and catching them where they are and keep them thinking about lawn and gardening.

William Bates Chappell
Truist Securities, Inc., Research Division

Well, and 2 things there. I mean, one, it doesn't sound like in years past, if you would -- made a decision to step up marketing at the start of the season and it wasn't working by mid-season, you'd scale it back and say, "Yes, never mind." But it does sound like this is here to stay, not just through this season, but this level is there for multiple years. Is that fair?

Cory T. Miller
Senior VP & Interim CFO

Well, that is what we're hoping for from a consumer takeaway. And we're going to continue investing in that to make sure that the consumers keep coming back and we give them a reason to keep coming back.

James D. King
Chief Communications Officer & Executive VP

Bill, the other part of it that I think gives us more confidence in the spend is a completely different approach than what we've done in the past. So historically, if you go back anything beyond prior to probably 2019, the vast majority of the spend was on television, okay? And very expensive, a lot of upfront that you had to buy and kind of a blanketed approach.

The approach that we're taking today is different from that for the most part as you can be, very targeted, very precise using a lot of digital tools. You could have a couple living in the same house, engaging in the same garden who are getting different messages from us on different mediums based on their own kind of personal interest and so forth.

And we're spending a lot more time with real-time analytics to understand how to talk to those individual consumers and understand the uptake from them. And I think that part of what we're doing here just gives us more confidence in the spend than we've had in the past as well.

William Bates Chappell
Truist Securities, Inc., Research Division

Which ties in well to the Super Bowl [indiscernible]. And then -- and I asked that in that, one, [indiscernible] what it's saying in that I think it's that ads showcase a lot of different demographics that are participating in your category. And it seems like you're going to reach it. And then, two, the question is, why are you [indiscernible] in February when the season doesn't start for 12 weeks or 8 weeks in most of the country? And is -- I understand expanding it, but that's a big swing for the fences.

James D. King
Chief Communications Officer & Executive VP

Yes. So it's really -- it's a really good question. And I think it ties together all the things that Cory and I really have been saying. So you could look at the Super Bowl ad in the context of the TV commercial. And in the context of a TV commercial, you could say, "Yes, there's a lot of demographics there, but then let's break down the TV commercial."

The commercial was not about our products at all. In fact, you never saw our products, except like there was a pallet of products that a person was standing in front of. But in terms of the celebrities who are engaging in the commercial, they weren't using our products. They were grilling. They were exercising. They were mowing the lawn. They were doing things that real people do in their backyards. And a lot of what you'll see us doing going forward is talking to people about their space and how they use their space and make it relevant to them.

People don't wake up on a Saturday morning and go to a Home Depot or Lowe's or a Walmart or an Ace or anywhere else to buy a bag of dirt because they enjoy going out and buying a bag of dirt. They're doing it because they're engaging in something else. So part of the ad was to showcase that.

However, if you break it down further, it really -- you got to look at it way beyond the TV commercial, and it was part of an 8-week campaign to drive consumer participation in a sweepstakes activity. And we have been able to gather hundreds of thousands of pieces of data from individual customer, individual retailers -- or consumers rather, who said, "I want to participate in your sweepstakes." And they've given us permission to talk to them very explicitly based on their participation in this.

So it really was not just about running an ad on February 3 so we could say we had a Super Bowl ad. It was, I think, a very well thought out, well-constructed campaign that's still playing out right now. You're still seeing it on Instagram, you're still seeing it on Twitter, on Facebook, on TikTok. And we continue every day to get more and more consumers who are engaging and giving us their personal data to communicate with them going forward based on running that ad. So I think it was a really good investment for us in the end.

William Bates Chappell
Truist Securities, Inc., Research Division

Got you. And has anybody won the sweepstakes yet?

James D. King
Chief Communications Officer & Executive VP

Not yet. What we're going to be doing is giving people rewards over the course of the season, one a day, I think, or several a day, I can't remember, but...

Cory T. Miller
Senior VP & Interim CFO

Yes, I think there's [40 to 100].

James D. King
Chief Communications Officer & Executive VP

[indiscernible] done, yes. So there's time, Bill. There's still time to jump in on it.

William Bates Chappell
Truist Securities, Inc., Research Division

I'll get the rest of my family to enter this. You never have too many chances.

Thinking about just how consumers spend and again, lawn and gardening, one of the things we've seen in a lot of CPG categories is a migration up to trusted brands. And I did know -- I mean I know you do a lot of the store brands for some of the customers anyway. But then did you see a migration up to more branded, trusted products, especially from some of these new entrants into the category?

Cory T. Miller

Senior VP & Interim CFO

I think if you look across all the categories, the -- we're flat to up in every category. And so I don't know that we saw that shift because it was more trusted, but I know that as a business, we saw every category that we have being flat to up from a share standpoint.

And some of that could be the messaging we put out there. Some of it could be the ability we had to service the customers and the inventories that were on the shelf. And some of it could be exactly what you're saying is that there's a shift to trusted brands during this time period. But certainly, we've seen strong share gains over the period, and we're looking for that to continue.

William Bates Chappell
Truist Securities, Inc., Research Division

And talk a little bit about pricing elasticity. I mean it was much more of a subject years ago when urea was spiking. And I know the company has done -- tried to add 1% to 2% pricing for the past few years. Is there still a lot of pushback from retailers? I mean it would sound like they're so excited about the category and the customer who's only buying this product once a year or twice a year isn't really that price-sensitive anyways. They don't know what they paid last year. So I mean, has that changed? Is that there still room for pricing from here? Or how do you look at that?

James D. King
Chief Communications Officer & Executive VP

So Bill, the elasticity question, when we're seeing more elasticity, I mean, you've been covering us for a long time -- I won't out you, but it's been for a long time, right?

So we had periods of time, a decade ago or more, when we did see a little bit more price elasticity. But we were taking in some of those years, like 8%, 9% pricing. In aggregate, I believe it was 2009. We took 35% pricing in fertilizer in 1 year because the commodities had tripled in that time frame.

So yes, we were seeing some elasticity then for sure and saw some contraction in terms of consumer participation in fertilizer, in particular, as the prices move so quickly. That said, sales dollars were higher than they've ever been. Sales profit dollars were higher than they've ever been. So it benefited us in the end and I think have pulled a lot of people back into the category over time.

But since then, we've not seen a whole lot of price elasticity from the consumer for exactly the reason that you mentioned. First of all, it's an infrequent purchase and people don't buy the product more than a handful of times a year. It's a seasonal purchase. So even if you're buying the same bag of lawn fertilizer every March or April, you don't really remember what you paid a year ago.

The other part of it is that we have been kind of consistent and I think fairly modest in the kind of pricing that we've taken. So we haven't spooked the consumer away by big price increases. I think, Cory, you can elaborate on this. I mean retailers are never going to throw a party for a price increase. But we've been historically able to get pricing over the line when we felt like we needed to, and that's been in most years.

Cory T. Miller
Senior VP & Interim CFO

Yes. And we look at pricing as a way to expand the category, make sure that we're covering costs, we don't want to have pricing every month, every quarter into the consumer business. So it's an annual process that we go in and take some time to sell that pricing in. But we try to not go in too heavily handed either. And we make sure that the retailers, the consumer and Scotts sits at a good position after the pricing has taken, and nobody is feeling too much undue pain.

William Bates Chappell
Truist Securities, Inc., Research Division

Got it. Can you just -- talking [indiscernible] can you just remind us of key commodity inputs for the lawn and garden business, the hedging strategy, kind of where we stand and outlook and if there's even -- at this point? Typically, your pricing could be done last November. So maybe just to understand how we look at it as we stand here in February.

Cory T. Miller
Senior VP & Interim CFO

Yes. So the way we sit today, we are getting pressure on some of our commodity inputs: urea, resin, diesel. And actually, the freight market is a commodity that we look at, and we are seeing pressure there as well.

But as you look at the price increases that we've seen here recently, we do have the ability to push some of that off for this season at least because of the amount that we have fixed or hedged at this point. So we have locked in about 3/4 of our commodity costs for this year. We did see some pressure in the portion that was not locked, which is why when we gave guidance last time, we mentioned that item as the pressure that we are facing as we go throughout the rest of the year.

And we're kind of weighing the cost that we're seeing today and what we think could happen over the rest of the year against the need for inventory at the end of the year to make sure we're meeting the demand that the customers have and making sure that we are building the appropriate level of inventory. And as we go through that process to make sure our ending inventory is appropriate, it has exposed us a little bit more than our plan originally called for because the percent locked went down as our production forecast went up a little bit.

But we look at how we expect the rest of the year to go and feel like we've baked that in adequately in the plan that we have. But it is a moving target to figure out where these commodities will land and when the increase will stop.

William Bates Chappell
Truist Securities, Inc., Research Division

I guess put another way, you're saying your thoughts on how much of 2020's growth you would retain has gone up, but at the same point, you can't plan for that. So that's where -- incremental. So it's a high-class problem for you.

Cory T. Miller
Senior VP & Interim CFO

Yes, that's right.

William Bates Chappell
Truist Securities, Inc., Research Division

Just last kind of one on -- and not to -- well, last 2 on lawn and garden. Just any kind of Roundup due in the past year? It seems like a lifetime and a pandemic ago that we were talking about Roundup and litigation in Monsanto and stuff like that. But it seems that you don't hear a whole lot a lot about the business anymore. It seems fairly stable. So any update there would be great.

Cory T. Miller
Senior VP & Interim CFO

I'll just start out by saying what the business did. If you look at last year, it was up double digits, consistent with the rest of the business. So the Roundup brand continues to sell through the trade. So things look really good from a shipment and a shipment POS standpoint. Jim, I don't know if you have any other comments, but I think the business is performing well.

James D. King
Chief Communications Officer & Executive VP

Yes, the business performed well, Bill. We've restructured the relationship with Bayer a couple of years ago. So I think we're in a better position there. So the business is -- it's healthy. It's doing fine. We like the relationship. I think we've also put ourselves in a good spot with the investments that we've made in the Ortho GroundClear brand, which have been kind of a nice complement.

So at the end of the day, if we saw any consumers who were choosing to move away from the Roundup brand, if they were moving into the Ortho brand, for us, it's moving from one stack to the next. So it's -- we're kind of agnostic about that. But the business has been performing very well. And the [occupational] kind of component of the Roundup brand have been very steady as well as something that we look at all the time.

William Bates Chappell
Truist Securities, Inc., Research Division

Got it. And then no, I mean, it doesn't sound like there are a lot lingering consumer concerns that really impacted the brand in 2020.

James D. King
Chief Communications Officer & Executive VP

No.

William Bates Chappell
Truist Securities, Inc., Research Division

Last one, just because it's timely. How concerned should I be that it was freezing in Texas in the month of February? And -- or someone was happy to point out to me that Pennsylvania had snow on the ground for every day of the month of February for the first time in like 50 years.

James D. King
Chief Communications Officer & Executive VP

Well, if you were planning on planting your tomatoes last week in Dallas, it was a really bad week. So I'll lead with that. No, February -- even in Texas, February is not the time of the year where we sit here and wring our hands about weather. It tends to just push activity from one week to another week or one month to another month or one quarter to another quarter, but it kind of comes full circle to some of your questions on marketing.

People who are engaging in gardening are going to garden. If they have to push it out a little bit of time, they're going to push it out a little bit of time. And weather for our business tends to even itself out more years than not. Either by geography or by product category, weather kind of self-corrects. So if we lost 2 weeks in Texas in the middle of April, we might be a little bit more concerned, but losing a couple of weeks in early February or mid-February is not a huge deal.

William Bates Chappell
Truist Securities, Inc., Research Division

Got it. Switching over to Hawthorne. Again, looking back, and I still don't fully understand. I mean I understand why Hawthorne is growing so well and doing gangbusters. I don't really understand why when the lockdowns happened last year, it accelerated. And when I say that, and Jim, I think I've asked this with you before, and it was like growing 10%, 20%. And all of sudden, it's growing 50%, 60%, 70%.

And while it makes sense that we're locked down and consuming maybe more -- people are consuming more cannabis products, your hydroponics don't spit out gummy bears or other cannabis products. I mean, they're for growers to then create production 6 months down the road. So why did it just hit the market? Any idea looking back?

Cory T. Miller
Senior VP & Interim CFO

Yes. Bill, I think if you look back at the growth for Hawthorne, we've been growing at about 70% year-over-year back to June of 2019. So we were seeing that kind of growth before the pandemic hit. And once the pandemic hit, the growth versus the expectations that we have, it continued to go higher, but growth versus the growth we had seen in the previous months, it stayed about the same. So we've been growing at that rate for 18 months now.

And there -- I mean, if you look at what happened since the pandemic, we certainly had a strong finish to last year. We're not able to look at what that finish would have been without the pandemic. But I tend to think that it wouldn't have been much different. There is some argument that the consumption of the end product did go up since the pandemic, and that caused some sell-in of our products as growers continue to build out their cultivation operations. There's probably some linkage there. It's tough to draw a straight line to make all that happen.

The new markets in Michigan and Oklahoma seem to be hitting their stride right about when that -- right about when the pandemic hit as well. So it could just be the timing of that market hitting or the pandemic.

William Bates Chappell
Truist Securities, Inc., Research Division

Well, it seem -- I was also struck that like California in 2020 was up 20%. I mean for a market that's legally or illegally been around for 30 years, and it's certainly the most mature market, any thoughts behind why that was so strong as well or saw a resurgence?

Cory T. Miller
Senior VP & Interim CFO

Yes. California was up about 70% last fiscal year. And a lot of this goes back to the changes that happened in '17 that caused some sales downturn for our business back in '18. And now you look at the growth rates that we've had coming out of that '18 year, and they've been really strong in California.

A lot of product innovation has allowed for sales to continue to be sold into the cultivators in California as they're upgrading their facilities. Lights, for example, shifting out of older HPS models into newer LED models. There's just been a lot of traditional growers that are still growing and producing in the state of California and just a lot of market conditions that are allowing for our products to continue to be sold in as growth continues to happen in the end product.

William Bates Chappell
Truist Securities, Inc., Research Division

And it's going to be, I mean, pretty encouraging. It's like fracking. You're basically finding oil in what you thought were heavily depleted wells and a lot to work. Is that a fair assessment?

Cory T. Miller
Senior VP & Interim CFO

Well, that's where innovation plays. We have to continue to look at the innovation that happens in the space with all categories, but lighting is an easy one to make the comparison.

Think about televisions, what your TV looked like 5 years ago. The TV could last 20 years, but you're probably still not -- you're not still watching the one that you had 20 years ago because of innovation that's happened from a tube TV through LED to QLED.

Lighting is kind of just like that. You're moving through the transition of the lighting fixtures into a more modern fixture, and that's the fixture that we're selling a lot of right now. If you think about our growth, a lot of it is in lighting in the SKUs that are innovative.

James D. King
Chief Communications Officer & Executive VP

And an innovation, Bill, that we've driven, okay? I mean I think that's probably a part of this that people shouldn't overlook. We get a lot of questions these days about how are we different from other players in the space, who people have come to better understand in recent months. And a big part of it is the innovation piece.

Just over the last couple of months, we finally opened our R&D facility in Kelowna, British Columbia. It's the only facility in the world that is focused on R&D around cannabis cultivation, okay? And we're testing lights. We're testing nutrients. We're testing the blending of things. So that's an important part of this.

And so when you have a technology that gets good enough like LED lighting, that justifies an existing cultivator to go in and retrofit their facility because they can put in very expensive new lights, okay? Those are -- it's a big capital investment. But what it's doing is bringing their utility costs down substantially, which is a big part of the big [indiscernible] and giving them the kind of product yield, plant yields that they still haven't expected.

So the innovation piece of this, I think, cannot be missed or understated at all or misunderstood at all. It's a really important part of the growth strategy at Hawthorne.

Cory T. Miller
Senior VP & Interim CFO

Yes. And just to add a little more color on that one. If you think of LEDs 2 years ago, we were just launching an LED product that we had sales just at the tail end of Q4 for a few million dollars. And we could do up to $250 million of LED sales this year just in the U.S. alone. So tremendous growth in that area.

William Bates Chappell
Truist Securities, Inc., Research Division

Absolutely. Can you just -- just [packing up] one of the questions I get and I'm sure you get is, what is the evolution of this kind of a state -- the new state that legalized some things in that market. I mean let's take New Jersey as an example. But even like Georgia, I mean Georgia has passed it from [indiscernible], and they're now bidding out 10 licenses and I think 150 people bidding on it. So -- but how does it work in terms of your business? Like when does the business start to hit its stride in terms of sales?

Cory T. Miller
Senior VP & Interim CFO

Yes. I mean, certainly, as new states come online and legalization passes in those states, it's good news for us long term. If you look at the states that have rolled out historically, there's usually a lag of 6 to 18 months before the bill passes until you get through all the regulatory phases to find out who the builders are going to be, of the growth facilities, how those facilities can be grown and then what products they actually put in them.

So certainly, we kind of had good news in the East last election cycle. We expect that to be good news for us. We just don't know how much of that good news will happen this fiscal year. It feels like it's likely going to fall into '22 before we see significant good news.

And remember, the states that are passing today are smaller states. So I mentioned 2018 before, we had kind of a downturn in '18 because legalization happened in the state of California, and it kind of froze what was happening in California. If you look at the states that are passing today on the East, our base in those states, because of how historically legalization has rolled out, our base is pretty small.

And we're kind of protected on the downside because we don't have a lot to lose from an existing sales standpoint. The upside is something that we feel like we can go capture, and we're in a good position to go capture as the build-out of these grows happen. But we do think that is a longer lead time until those grows actually happen and we see those shipments going out that affect our sales.

James D. King
Chief Communications Officer & Executive VP

Bill, let me elaborate on Cory's point to just help illustrate for people. And I use New Jersey because it's real time, right? So first week in November, 65%-35%, I think, was the percentage split, 67%-33% actually. New Jersey residents say, "Make recreational marijuana legal." It took until yesterday for the government apparatus to actually make marijuana legal in New Jersey. It finally was signed and passed yesterday.

Now it's got to go into a new kind of pipeline, and now there's got to be a regulatory regime put in place and all the rules and regs around cultivation and marketing and sales and used for a marketplace. That will take another 6 or 8 months to do that, okay?

And then you can finally have licenses issued, then people start actually cultivating cannabis. So you see it kind of moving through the snake pretty slowly even when you have a state that overwhelmingly approved moving forward with it. So it just takes time.

William Bates Chappell
Truist Securities, Inc., Research Division

Got it. And I think what's least understood by investors is just kind of the -- not supply chain, but just kind of the ecosystem of -- the game-changing moment for Hawthorne was buying Sunlight and being -- which was the largest distributor. And usually, buying a distributor does -- is a game-changing moment.

At the same point, you have -- your customers are smaller, midsized kind of commercial retailers that have very small and midsized customers. And so trying to understand like do you expect this to be the way business goes for the next 5 years? Do you expect it to go more commercial and smaller, bigger-type deals, albeit still in state by state? Or how do you expect the market to change over the next few years? And how is Scotts going to position for that change?

Cory T. Miller
Senior VP & Interim CFO

Well, I think it goes back to why we did the Sunlight acquisition. Sunlight was a distributor on their own, and they had some brands, but mainly a distributor. And they distributed our brands at the time, Gavita, GH, Botanicare, all were distributed by Sunlight. But we didn't really buy them because they were a distributor. We bought them because of the supply chain network that they had built already.

So we had -- I remember having a decision point as like, "Do we build a network and try to compete with them? Or do we go buy this network that's already established and try to tweak it to have more strength for our business?" And obviously, we decided to buy.

And as we bought that network, it did a couple of different things. We have systems in place that actually dealt with shipping product to that many customers. We had both like IT systems and processes and systems that allowed goods to actually move. We had just the customers and the contact and the sales force and everybody that, that had been actually calling on those customers. It allowed us to shortcut that process as well and lean on their relationships and the people that Sunlight at the time had in place.

And since we've acquired that business, we've done a lot of changes to all those things, but the relationships, the contact to the retail customers, the network that they built were all the things that we leaned on to make sure that as we improve the business and expanded the capacity that the business had, we could continue leaning on that channel and continue pushing our own brands through that network in a harder way than what Sunlight was doing before because they didn't have the same owned brand strength that we had owning that network.

So I think that's what the true strength of the Sunlight acquisition did for Hawthorne. And as you look to go forward, we're going to have a lot more distribution points than we do today. When I say distribution points, I mean end product -- end locations where we're going to ship product. And the network allows us to meet the needs that we're going to have in the future more than we could have just by building that network on our own.

And as we look for the need to expand the network or increase capacity and focus on more distribution points in the future, those decisions will be made for each location that we're operating in today. But buying the Sunlight business, almost 3 years ago at this point, gave us a giant leap forward in the ability to service the vast number of distribution points that this category, that brings to us.

William Bates Chappell
Truist Securities, Inc., Research Division

And just follow-up, do you expect the market to be more commercial in terms of fewer but bigger kind of basket sizes?

Cory T. Miller
Senior VP & Interim CFO

I think as legalization continues to roll out state by state, you're going to have several larger growers that are being built in every state. And we're going to look to service those customers in any way we can to make sure that they continue to come for Hawthorne products. If we get to a point where there's federal legalization and interstate commerce happens, I think we're entering a whole new game at that point and more consolidation could happen.

One man's opinion, I think that's pretty far off. As Jim said, the time period to make things happen on a state-by-state level is slower than one would expect. I think from a federal standpoint, it's likely to be even slower yet.

William Bates Chappell
Truist Securities, Inc., Research Division

And that's not all, I guess, bad for your business model. But is there a legislation out there that would help accelerate this business, I mean that's some banking laws, some stuff like that you see on the horizon?

James D. King
Chief Communications Officer & Executive VP

There are a couple of things, Bill. So not every state can legalize cannabis through the ballot box. So New York is a good example of that, okay? They don't offer ballot initiatives in New York. So that's likely to happen through the legislature. It's actually likely to happen through the budget process in the legislature, which I think most people believe will happen yet this year.

So there are a number of other states, where I think you probably will see some legislative activity. You just saw it in Virginia. It could happen in New York. There's further discussion about Pennsylvania. I know there are groups here in Ohio who are thinking about another ballot initiative again here. So I think you're going to see more and more momentum for that to happen at the state level.

At the federal level, there are individual bills, for example, to [say back], which is really focused on banking that's gained some traction, had gained some traction previously in the House, never really gained any traction in the Senate. There's still an appetite for that, but I'm not sure that you're going to see a narrow bill like that pass the Senate without some broader reforms, which are harder to get in the House than they would have been before even though broader reforms passed the House last year. I'm not sure that they would this year. So that would happen. That still could happen.

But you're still going to have, even if you have federal reforms, this transition period of actually having a regulatory framework in place. And I think more and more folks are believing that you're going to see these state regulations be that stop gap for some period of time.

If you look at hemp legalization a few years ago, the FDA still has not -- 3 years after the fact, has not put guidelines in place for that market. I think decriminalizing marijuana and then not having some framework to fall back on is not what anybody is looking to do here.

So I think the state framework likely stays in place for some period of time, which would be a good thing for us and I think the tens of thousands of cultivators and retailers who have actually been driving a lot of growth and creating a lot of jobs in this industry for the last several years.

William Bates Chappell
Truist Securities, Inc., Research Division

Got it. That's -- and then a couple more questions and I'll let you go. One of the questions I get, I think people think of traditional markets where the consumable, be it nutrients, be it other -- is much more that's a recurring revenue base, while your business is more reliant right now on the durable side. So how do you see that? How do you see it changing? What kind of impact does that have on margins as we go forward?

Cory T. Miller
Senior VP & Interim CFO

If you look at our business today, we certainly have had a lot of growth in sale -- in the sales of lighting, which has taken our durable percentage of the [total op]. We're about 2/3, durables, 1/3 consumables for Q1. I mean, in last year, for the full year, it was a little bit more balanced than that.

As the build-out phase continues to roll throughout the East, we expect the durable portion of our sales to continue to remain high. And at that same time, as we're building relationships with those grows and each of the individual grows might become more -- I guess, their sales will become more focused towards our consumable products, we want to capture that business.

Consumable products is -- they're very good for us from a margin perspective. Pushing our consumable products through existing grows is a big win from a margin standpoint. But we think that as that kind of happens, what you're seeing in California now will continue to happen throughout the country and throughout the other grows, where our durables are still in demand.

So I don't see that we're going to have 2 more years of durables and everything shifts to consumables. I think there's going to be a mix that happens. And then there's also going to be a mix between our signature brands and our distributed brands.

If you go back a couple of years, I want to say we sold 64 different brands of nutrients. And certainly, that's too many brands of nutrients for our business to be selling, either owned brands or distributed brands. So we'll continue to have a focus on pushing the owned brands that we have, making sure that the distributed brands that we're working with are large distributed brands that have a place in the market and are the brands that our consumers want out there versus something that we just kind of inherited and keep selling.

So the product mix is going to vary as we go through this period of a couple of years, both between consumables and durables, and then within each of the category within distributed and our signature, our own brands. So as it plays out, I think that any door you pick at the end of the road is kind of a good door for us because certainly, our own brands are higher margin. Our consumable products are higher margin for us.

And as durables continue to sell, it should be based on products that are new and innovative to the category, which we will be innovating those items to have a higher margin as well. So we're kind of focused on those aspects driving the margin for us as we go forward.

William Bates Chappell
Truist Securities, Inc., Research Division

Got it. I could keep going for another hour or so with questions, but I'll just end with the last one that I've been ending all of mines were and with regards to the pandemic, and I'll just change it a little bit because I know it's -- the pandemic has enhanced your growth opportunity. But maybe from an organizational standpoint, if you look back 3 years from now, will you think the pandemic strengthened the organization, weakened the organization or really didn't have that much of an impact on the organization on a go-forward basis and why?

James D. King
Chief Communications Officer & Executive VP

Made us way better. Way better. It was an interesting time, Bill. Most companies were scrambling last March to figure out how to get out the door and how to keep their business operating.

We started planning, in fact, last January for this possibility to occur. Think about our business, think about the seasonality of our business and what would have happened to our business had we not been prepared to walk out the door at the break of the season and keep things running, okay? So we were well prepared for it, have been planning for it for a couple of months and I think moved into it in a pretty seamless way.

I think the kind of collaboration that's occurred in the company over the last year because of the consumer demand, because of how well the category responded, because of what was happening in Hawthorne, it was -- while we had a good year, it was a hard year, okay? But we did that -- well, Cory and I happen to be in the building today. We're the only 2 people in the building today. And there's nobody that's here these days.

But I think it improved our collaboration. I think it improved the morale of the organization. I think it's made us more efficient. And I just think we come out of this as a better company, a smarter company than we were going in. I think it's been beneficial from that perspective.

Obviously, it goes without saying, if we could all take it back, none of us would have wanted this to happen. But I think we took a really difficult situation and made the best of it and come out much better and much stronger as a result.

Cory T. Miller
Senior VP & Interim CFO

Yes. I agree and I'd add to that. If you go to the beginning of the pandemic, I was in the Hawthorne business at the time. And Hawthorne was very decentralized. We operated like this for the last 3 or so years because our acquisitions had us all over the country.

We were in New York, Ohio, Arizona, Canada and out in the state of Washington. So we were really operating decentralized to begin with. And when the pandemic hit and we were forced to operate this way, it wasn't a big change for the Hawthorne side of the business. And I think the flexibility that we had in our work -- actually going through the acquisition process at Hawthorne, there are so many things that Hawthorne leaned on Scotts for. This is one where I actually think Scotts leaned on Hawthorne a little bit, and it allowed for that flexibility to happen in the daily way that we operate our business.

And I think we operate in a very efficient manner now. We kind of -- it's straight to business, straight to the decision at hand, and it allowed us to invest in the infrastructure that we needed to continue seeing the growth in our business. And I think that investment that we've made over the last year or so since we've been kind of remote working will help us in years to come.

And it's a different mindset that, while we're all doing something different physically and we're in different locations, we overcame that. We focused on the business and we continued to operate the business at -- in what -- hopefully, it's not the record year because I hope that we keep having record years. But for us to hit an existing record year in the middle of all that, I think, says a lot about the way we operate as a business. And Jim was right. It was a hard year, but it was a good year.

William Bates Chappell
Truist Securities, Inc., Research Division

That's fantastic. Well, thank you so much for your time. Thanks for being in our consumer symposium. I really appreciate the time and the feedback and the color. So have a great rest of the week.

James D. King
Chief Communications Officer & Executive VP

Yes, Bill. Thanks for having us.

Cory T. Miller
Senior VP & Interim CFO
Thank you, Bill.