

Scotts Miracle-Gro(SMG)

\$123.86 (As of 02/03/20)

Price Target (6-12 Months): **\$131.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/27/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: D

Summary

Scotts Miracle-Gro's losses narrowed year over year in first-quarter fiscal 2020. Adjusted loss per share was also narrower than the Zacks Consensus Estimate while sales surpassed the same. The company is expected to benefit from the synergies of the Sunlight Supply acquisition. The buyout provides the company with modern and cost-efficient supply chain in the hydroponic industry. Also, it is likely to gain from legally authorized cannabis production. The company will gain from long-term prospects and cost-saving opportunities associated with the Hawthorne division. Moreover, it is likely to gain from the new line of organic plant food products. The company has also outperformed the industry in the past year. However, the company is exposed to commodity cost headwinds. High debt level and stretched valuation are other concerns.

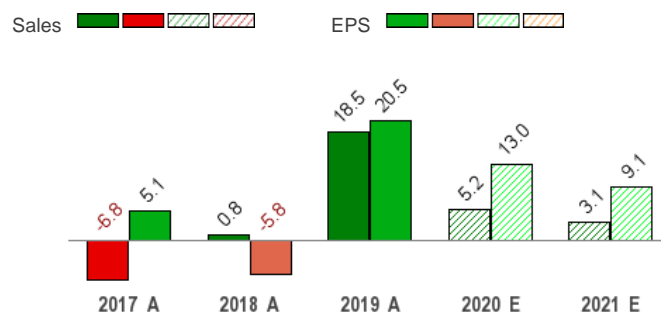
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$125.27 - \$73.90
20 Day Average Volume (sh)	405,055
Market Cap	\$6.9 B
YTD Price Change	16.7%
Beta	0.79
Dividend / Div Yld	\$2.32 / 1.9%
Industry	Fertilizers
Zacks Industry Rank	Bottom 3% (246 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.7%
Last Sales Surprise	5.2%
EPS F1 Est- 4 week change	0.6%
Expected Report Date	05/06/2020
Earnings ESP	1.0%
P/E TTM	26.2
P/E F1	24.5
PEG F1	2.3
P/S TTM	2.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	383 E	1,279 E	1,245 E	541 E	3,422 E
2020	366 A	1,234 E	1,196 E	515 E	3,320 E
2019	298 A	1,190 A	1,170 A	498 A	3,156 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	-\$1.10 E	\$3.98 E	\$3.50 E	-\$0.79 E	\$5.51 E
2020	-\$1.12 A	\$3.72 E	\$3.22 E	-\$0.77 E	\$5.05 E
2019	-\$1.39 A	\$3.64 A	\$3.11 A	-\$0.91 A	\$4.47 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/03/2020. The reports text is as of 02/04/2020.

Overview

Based in Marysville, OH, The Scotts Miracle-Gro Company is a leading producer and marketer of branded garden and consumer lawn products. The company makes, markets and sells garden and lawn products in various categories including Lawn Care, Gardening and Landscape, Hydroponics, Controls and Marketing Agreement.

The company's products are marketed under some of the most recognized brand names in North America like Scotts and Turf Builder lawn and grass seed products, LiquaFeed and Osmocote gardening and landscape products.

In the United Kingdom, some of its major brands are Miracle-Gro plant fertilizers, EverGreen lawn fertilizers, Weedol and Pathclear herbicides and Levington gardening and landscape products.

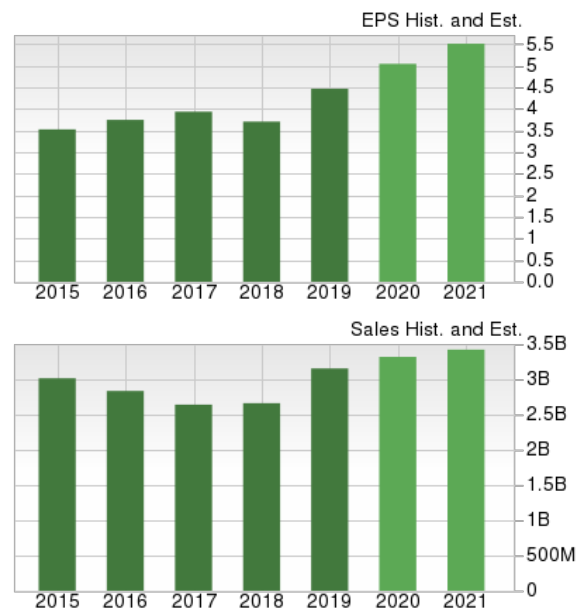
Scotts Miracle-Gro's operations are mainly focused on three reportable business segments — U.S. Consumer, Hawthorne and Other.

U.S. Consumer (72% of Fiscal 2019 Sales) – The division consists of consumer garden and lawn business located in the United States. The lawn care products include lawn fertilizers, grass seed products along with lawn-related pest, weed and disease control products. The landscape and gardening category enable consumers to grow vegetable and flower gardens and beautify landscape. It includes complete array water-soluble plant foods.

Hawthorne (21%) – The segment consists of urban, indoor and hydroponic gardening business. The hydroponic category enables consumers to grow flowers, plants as well as vegetables in an urban and indoor environment using very little or no soil.

Other (7%) – This division consists of consumer lawn and garden business in regions other than the United States and the products are sold to commercial nurseries, greenhouses and other professional customers.

In June 2018, the company's Hawthorne division acquired all the assets along with certain liabilities of Sunlight Supply, Inc and subsidiaries. Notably, Sunlight Supply is the largest distributor of hydroponic products in the United States. The buyout strengthens the Scotts Miracle-Gro's Hawthorne segment.



Reasons To Buy:

- ▲ Scotts Miracle-Gro has outperformed the industry it belongs to in the past year. The company's shares have gained 63.4% in this period against the industry's 18.3% decline. The company should gain from the synergies of the Sunlight Supply acquisition. The buyout creates unique competitive advantages for the company's Hawthorne division. The acquisition provides the company with most modern and cost-efficient supply chain in the hydroponic industry that will benefit its retail customers and end-consumers. As a result of the acquisition, the company expects year-over-year improvement in adjusted EPS as well as growth in total sales and gross margin. Moreover, net sales in the Hawthorne segment surged 95% in fiscal 2019, partly driven by the favorable impact of Sunlight Supply buyout.
- ▲ Scotts Miracle-Gro is likely to benefit from the continued long-term prospects and cost savings opportunities associated with its Hawthorne division. In third-quarter fiscal 2018, the company announced the launch of an initiative called Project Catalyst. The project is a company-wide restructuring effort to reduce operating costs throughout the Hawthorne, U.S. Consumer and Other units. Over the trailing 12 months period ending Sep 30, 2019, the company continued to execute on its planned facility closures and consolidations. Also, net sales in the Hawthorne segment rose 41% year over year in the last reported quarter. The company anticipates Hawthorne's sales to grow 12-15% in fiscal 2020. It believes that sales in the Hawthorne unit will likely increase by around 20% in second-quarter fiscal 2020.
- ▲ The company's prospects for the hydroponic products remain bright in the long-term. It is a leading provider of nutrients, lighting and other materials that are used in the hydroponic growing segment. In the last reported quarter, the United States' hydroponics and indoor growing businesses went up 66%. The company remains bullish on the long-term prospects for the division's strong leadership position. The company also believes that there will be growth and investment in the business. The company is focused on bringing new products to the market in the consumer segment. Also, it is likely to gain from legally authorized cannabis production as the cannabis industry grows in the United States and Canada.
- ▲ The company is likely to gain from its new line of organic plant food and growing media products — Miracle-Gro Performance Organics. This is the first organic product line that delivers performance at par with synthetic products. The company believes that Performance Organics will be a major new product and has the potential to transform the gardening industry category. The company is also expected to add new consumers into the space. It is witnessing strong growth in its GroundClear and Performance Organics products line. Notably, Performance Organics delivered sales of nearly \$40 million in the first year (fiscal 2019). It also helped to drive a 6% improvement in the consumer purchases of the company's branded soils. The company expects the momentum to continue in fiscal 2020.

Scotts Miracle-Gro should benefit from the synergies of the Sunlight Supply acquisition. The company should also gain from the long-term prospects and cost savings opportunities associated with its Hawthorne division.

Reasons To Sell:

- ▼ The company is exposed to commodity cost headwinds. While the company is somewhat insulated from market movements due to its hedging program, aggregate impact of commodities continues to be a concern. At the end of fiscal first quarter, around 75% of company's commodity costs were locked in for the year. Moreover, it believes that the net effect of tariffs (after the recent signing of the trade deal with China) is expected to remain a headwind as well.
- ▼ The company's high debt level is a concern. The debt-to-equity ratio of the company is 210.7%, much higher than industry's average of 42.2%. Notably, its cash and cash equivalents were \$27.4 million at the end of the last reported quarter, while long-term debt was \$1,969.9 million.
- ▼ The company's stretched valuation is another concern. In case of Scotts Miracle-Gro, the trailing 12-month EV/EBITDA multiple (a preferred valuation metric for cyclical industries) is 26.19 while its industry's trailing 12-month EV/EBITDA multiple is lower at 6.04. As such, investors might not want to pay more for the stock at present.

Scotts Miracle-Gro is exposed to commodity cost headwinds, which may continue to exert pressure on margins. High debt level and stretched valuation are other concerns.

Last Earnings Report

Scotts Miracle-Gro's Q1 Earnings & Sales Beat Estimates

Scotts Miracle-Gro posted net loss from continuing operations of \$71.3 million or \$1.28 per share in first-quarter fiscal 2020 (ended Dec 28, 2019). The figure is narrower than a loss of \$82.6 million or \$1.49 per share in the year-ago quarter.

Barring one-time items, adjusted loss per share was \$1.12, narrower than a loss of \$1.39 in the year-ago quarter. The figure was also narrower than the Zacks Consensus Estimate of a loss of \$1.24.

Net sales rose 23% year over year to \$365.8 million. The figure surpassed the consensus mark of \$347.7 million.

Company-wide gross margin rate (as reported) rose to 14.8% from 11.6% in the year-ago quarter.

Segment Details

In fiscal first quarter, net sales in the U.S. Consumer division rose 8% year over year to \$147.4 million. The segment reported a loss of \$41.5 million, which is narrower than a loss of \$43.1 million in the year-ago quarter.

Net sales in the Hawthorne segment rose 41% year over year to \$198.8 million in the reported quarter, which was primarily driven by strong demand in almost all categories of indoor growing equipment and supplies. The segment's profit surged 216% year over year to \$13.9 million.

Net sales in the Other segment fell 4% year over year to \$19.6 million. The segment incurred a net loss of \$3.5 million in the reported quarter, which is lower than a loss of \$4 million in the year-ago quarter.

Balance Sheet

In fiscal first quarter, the company had cash and cash equivalents of \$27.4 million, up 21.2% year over year. Long-term debt was \$1,969.9 million, down 9.9% year over year.

Outlook

The company witnessed strong momentum in the U.S. Consumer unit in fiscal 2019, which also continued into fiscal 2020. Moreover, it continues to see outstanding performance across all product categories in the Hawthorne business in the United States.

Going forward, the company is upbeat on achieving its fiscal 2020 guidance. Scotts Miracle-Gro expects company-wide sales growth in the range of 4-6% for fiscal 2020. It continues to expect adjusted earnings per share in the band of \$4.95-\$5.15 for fiscal 2020.

Free cash flow is projected to be around \$300 million.

Quarter Ending **12/2019**

Report Date	Jan 29, 2020
Sales Surprise	5.20%
EPS Surprise	9.68%
Quarterly EPS	-1.12
Annual EPS (TTM)	4.72

Recent News

Scotts Miracle-Gro Announces Quarterly Dividend – Jan 27, 2020

Scotts Miracle-Gro's board has declared a quarterly cash dividend payout of 58 cents per share to shareholders. The dividend is payable on Mar 10, 2020 to shareholders on record as of Feb 25, 2020.

Scotts Miracle-Gro Begins Exchange of Senior Notes Due 2029 - Jan 10, 2020

Scotts Miracle-Gro has started a registered exchange offer to exchange all and any of its \$450 million total principal amount of 4.5% senior notes due 2029 (referred to as original notes). The notes were issued through a private placement on Oct 22, 2019 for an equal principal amount of its 4.5% senior notes due 2029, which have been registered under the Securities Act of 1933 as amended (referred to as the exchange notes).

Scotts Miracle-Gro stated that the exchange offer will meet its obligations under a registration rights agreement entered on Oct 22, 2019, related to the issuance of the original notes. Notably, the exchange does not mark a new financing transaction and the company will not receive any additional proceeds from the exchange offer.

Moreover, the terms of the original notes and exchange notes are substantially identical except some transfer restrictions, additional interest provisions and registration rights are not applicable to the exchange notes. The original notes that are not exchanged will continue to be subject to prevailing transfer restrictions. The company will not have the obligation to provide for the registration of those notes under the Securities Act of 1933.

Unless extended by the company, the exchange offer is slated to expire on Feb 10, 2020. The tenders of the original notes must be validated at or prior to the time of expiry. They may also be withdrawn at any time prior to the expiration time.

Valuation

Scotts Miracle-Gro's shares are up 63.4% over the trailing 12-month period. Over the past year, the Zacks Fertilizers industry and the Zacks Basic Materials sector are down 18.3% and 8.2%, respectively.

The S&P 500 index is up 17.4% in the past year.

The stock is currently trading at 23.78X forward 12-month earnings, which compares to 16.58X for the Zacks sub-industry, 12.59X for the Zacks sector and 18.5X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.81X and as low as 13.73X, with a 5-year median of 18.67X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$131 price target reflects 25.51X forward 12-month earnings per share.

The table below shows summary valuation data for SMG:

Valuation Multiples - SMG					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	23.78	16.58	12.59	18.5
	5-Year High	24.81	41.13	21.14	19.34
	5-Year Low	13.73	10.16	9.77	15.18
	5-Year Median	18.67	17.51	13.7	17.46
EV/EBITDA TTM	Current	26.19	6.04	9.01	11.95
	5-Year High	30.3	20.89	18.18	12.85
	5-Year Low	10.97	6.04	7.34	8.49
	5-Year Median	13.67	9.11	10.58	10.66
P/B TTM	Current	10.99	1.05	2.18	4.4
	5-Year High	18.03	2.48	3.54	4.54
	5-Year Low	5.05	1.02	1.34	2.85
	5-Year Median	7.81	1.37	2.18	3.62

As of 02/03/2020

Industry Analysis Zacks Industry Rank: Bottom 3% (246 out of 254)



Top Peers

Aurora Cannabis Inc. (ACB)	Neutral
Aphria Inc. (APHA)	Neutral
Central Garden & Pet Company (CENT)	Neutral
Canopy Growth Corporation (CGC)	Neutral
Cronos Group Inc. (CRON)	Neutral
GW Pharmaceuticals PLC (GWPH)	Neutral
Reckitt Benckiser Group PLC (RBGLY)	Neutral
Spectrum Brands Holdings Inc. (SPB)	Neutral

Industry Comparison Industry: Fertilizers				Industry Peers		
	SMG Neutral	X Industry	S&P 500	CENT Neutral	RBGLY Neutral	SPB Neutral
VGM Score	C	-	-	B	D	A
Market Cap	6.91 B	6.91 B	23.66 B	1.77 B	59.68 B	2.77 B
# of Analysts	5	4	13	4	2	3
Dividend Yield	1.87%	1.27%	1.82%	0.00%	2.00%	2.79%
Value Score	C	-	-	C	D	A
Cash/Price	0.00	0.09	0.04	0.28	NA	0.22
EV/EBITDA	11.46	8.43	13.87	9.11	NA	11.76
PEG Ratio	2.32	2.48	1.97	2.75	10.07	1.05
Price/Book (P/B)	10.99	0.90	3.24	1.79	3.02	1.72
Price/Cash Flow (P/CF)	20.15	7.79	13.40	12.28	16.16	6.02
P/E (F1)	24.53	16.69	18.48	19.74	20.15	16.60
Price/Sales (P/S)	2.14	1.21	2.60	0.74	NA	0.73
Earnings Yield	4.08%	5.99%	5.40%	5.08%	4.93%	6.02%
Debt/Equity	3.13	0.41	0.72	0.70	NA	1.30
Cash Flow (\$/share)	6.15	3.48	6.92	2.58	1.04	9.99
Growth Score	C	-	-	B	C	A
Hist. EPS Growth (3-5 yrs)	5.29%	-12.13%	10.80%	30.26%	NA	NA
Proj. EPS Growth (F1/F0)	12.93%	12.12%	7.46%	0.31%	-3.47%	26.69%
Curr. Cash Flow Growth	15.63%	42.96%	10.59%	-4.06%	30.07%	64.31%
Hist. Cash Flow Growth (3-5 yrs)	4.73%	-4.30%	8.55%	21.71%	0.96%	16.24%
Current Ratio	2.19	1.62	1.21	4.69	NA	1.45
Debt/Capital	75.79%	29.68%	42.91%	41.03%	NA	56.48%
Net Margin	14.54%	8.50%	11.76%	3.89%	NA	14.35%
Return on Equity	38.31%	6.49%	17.24%	9.26%	NA	7.84%
Sales/Assets	0.93	0.45	0.55	1.18	NA	0.71
Proj. Sales Growth (F1/F0)	4.78%	1.70%	4.22%	1.93%	0.60%	1.30%
Momentum Score	D	-	-	B	F	B
Daily Price Chg	0.91%	0.00%	0.67%	-1.65%	-0.03%	-2.07%
1 Week Price Chg	12.98%	0.00%	-2.60%	-0.06%	3.51%	0.77%
4 Week Price Chg	17.90%	-1.93%	-0.76%	1.83%	1.60%	-6.18%
12 Week Price Chg	16.58%	-2.32%	2.84%	4.76%	10.11%	15.70%
52 Week Price Chg	63.40%	-16.73%	13.93%	-19.92%	9.01%	3.96%
20 Day Average Volume	405,055	114,387	1,915,782	51,297	278,129	448,523
(F1) EPS Est 1 week change	0.60%	0.00%	0.00%	0.00%	0.00%	-0.28%
(F1) EPS Est 4 week change	0.60%	-7.45%	0.00%	0.00%	-1.76%	-0.28%
(F1) EPS Est 12 week change	2.85%	-13.63%	-0.13%	-15.53%	-4.57%	-6.37%
(Q1) EPS Est Mthly Chg	-0.53%	-16.13%	0.00%	0.00%	NA	8.33%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	D
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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