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Jan 20, 2020

## Scotts Miracle-Gro(SMG)

**$111.65** (As of 01/17/20)

Price Target (6-12 Months): **$117.00**

| | | |
|---|---|---|
| Long Term: 6-12 Months | **Zacks Recommendation:** | **Neutral** |
| | (Since: 11/27/19) | |
| | Prior Recommendation: Outperform | |
| Short Term: 1-3 Months | **Zacks Rank:** (1-5) | **3-Hold** |
| | Zacks Style Scores: | VGM:C |
| | Value: C \| Growth: C | Momentum: D |

## Summary

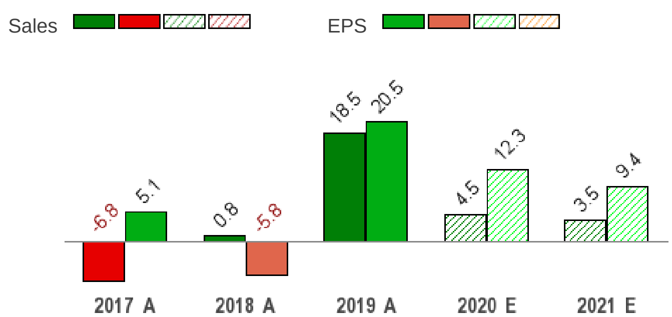
Annual earnings estimates for Scotts Miracle-Gro have been stable over the past month. The company is expected to benefit from the synergies of the Sunlight Supply acquisition. The buyout provides the company with modern and cost-efficient supply chain in the hydroponic industry. Also, Scotts Miracle-Gro 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, Scotts Miracle-Gro is exposed to higher distribution expenses, which is expected to exert pressure on margins. High debt level and stretched valuation are other concerns.

## Price, Consensus & Surprise


## Data Overview

| | |
|---|---|
| 52 Week High-Low | **$114.63 - $66.96** |
| 20 Day Average Volume (sh) | **342,398** |
| Market Cap | **$6.2 B** |
| YTD Price Change | **5.2%** |
| Beta | **0.79** |
| Dividend / Div Yld | **$2.32 / 2.1%** |
| Industry | **Fertilizers** |
| Zacks Industry Rank | **Bottom 2% (250 out of 254)** |
| Last EPS Surprise | **-4.6%** |
| Last Sales Surprise | **10.5%** |
| EPS F1 Est- 4 week change | **0.0%** |
| Expected Report Date | **01/29/2020** |
| Earnings ESP | **0.0%** |
| P/E TTM | **25.1** |
| P/E F1 | **22.2** |
| PEG F1 | **2.1** |
| P/S TTM | **2.0** |

## Sales and EPS Growth Rates (Y/Y %)




## Sales Estimates (millions of $)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|---|---|---|---|---|---|
| 2021 | 364 E | 1,280 E | 1,248 E | 547 E | 3,414 E |
| 2020 | 348 E | 1,234 E | 1,197 E | 518 E | 3,297 E |
| 2019 | 298 A | 1,190 A | 1,170 A | 498 A | 3,156 A |

## EPS Estimates

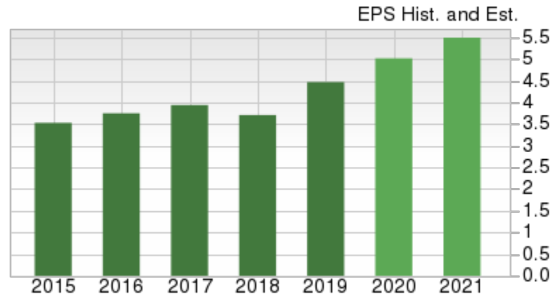
| | Q1 | Q2 | Q3 | Q4 | Annual* |
|---|---|---|---|---|---|
| 2021 | -$1.25 E | $4.02 E | $3.54 E | -$0.79 E | $5.49 E |
| 2020 | -$1.25 E | $3.74 E | $3.25 E | -$0.75 E | $5.02 E |
| 2019 | -$1.39 A | $3.64 A | $3.11 A | -$0.91 A | $4.47 A |

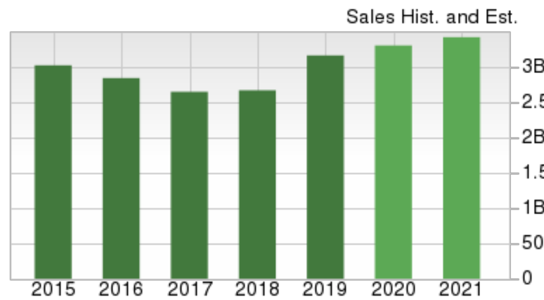
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/17/2020. The reports text is as of 01/20/2020.

## 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 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.

- Scotts Miracle-Gro has outperformed the industry it belongs to in the past year. The company's shares have gained 61.1% in this period against the industry's 11% 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 impact of Sunlight Supply buyout. The company anticipates Hawthorne's sales to grow 12-15% in fiscal 2020.

- 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.

- 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. 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. 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.

## Reasons To Sell:

- The company is exposed to higher distribution expenses. Adjusted gross margin rate declined year over year in the last reported quarter mainly due to higher distribution costs. The company's operating expenses, mainly Selling, general and administrative (SG&A) rose 14% year over year in the last reported quarter partly due to higher marketing investment and the unfavorable impact of the Sunlight Supply acquisition. The same also increased 11% year over year in fiscal 2019. As such, higher costs may continue to exert pressure on margins.

Scotts Miracle-Gro is exposed to higher distribution expenses, which is expected to exert pressure on margins. High debt level and stretched valuation are other concerns.

- 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%. Moreover, its cash and cash equivalents fell 44.5% year over year to $18.8 million at the end of fiscal 2019, while long-term debt was $1,523.5 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 22.9 while its industry's trailing 12-month EV/EBITDA multiple is lower at 5.97. As such, investors might not want to pay more for the stock at present.

## Last Earnings Report

**Scotts Miracle-Gro's Q4 Earnings Miss, Sales Top Estimates**

| Quarter Ending | 09/2019 |
|---|---|
| Report Date | Nov 06, 2019 |
| Sales Surprise | 10.45% |
| EPS Surprise | -4.60% |
| Quarterly EPS | -0.91 |
| Annual EPS (TTM) | 4.45 |

Scotts Miracle-Gro posted net loss from continuing operations of $55.5 million or 99 cents per share in fourth-quarter fiscal 2019 (ended Sep 30, 2019), narrower than loss of $130.6 million or $2.36 per share in the year-ago quarter.

Barring one-time items, adjusted loss per share was 91 cents, wider than loss of 75 cents a year ago. The figure was also wider than the Zacks Consensus Estimate of loss of 87 cents per share.

Net sales rose around 15% year over year to $497.7 million. The figure surpassed the consensus mark of $451 million.

Company-wide gross margin rate rose to 18% from 17% in the year-ago quarter.

**Fiscal 2019 Results**

Adjusted net income for fiscal 2019 rose 19% year over year to $251.8 million or $4.47 per share, while net sales rose 18% to $3,156 million.

**Segment Details**

In the fiscal fourth quarter, net sales in the U.S. Consumer division rose 4% year over year to $261.6 million. The segment generated loss of $20.7 million against net profit of $5.3 million in the year-ago quarter.

Net sales in the Hawthorne segment rose nearly 38% to $210 million in the quarter, which was primarily driven by strong demand across the United States. The segment's profit grew to $21.9 million from $0.5 million a year ago.

Net sales in the Other segment fell 10% to $26.1 million. The segment generated loss of $2.6 million against net profit of $0.7 million in the year-ago quarter.

**Balance Sheet**

At the end of fiscal 2019, the company had cash and cash equivalents of $18.8 million, down 44.5% year over year. Long-term debt was $1,523.5 million, down 19.2%.

**Outlook**

Scotts Miracle-Gro expects company-wide sales growth of 4-6% for fiscal 2020. Moreover, the company anticipates Hawthorne's sales to grow 12-15% and U.S. Consumer sales to rise 1-3%.

It expects adjusted earnings per share of $4.95-$5.15 for fiscal 2020.

Free cash flow is expected to be $300 million.

## Recent News

**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.

**Scotts Miracle-Gro Announces Quarterly Dividend** – Nov 5, 2019

Scotts Miracle-Gro's board has approved a quarterly cash dividend payout of 58 cents per share to shareholders. The dividend was paid on Dec 10, 2019 to shareholders on record as of Nov 26, 2019.

**Scotts Miracle-Gro Upsizes & Prices Senior Notes Due 2029** – Oct 8, 2019

Scotts Miracle-Gro has announced the pricing of its offering of $450 million total principal amount of 4.5% senior notes due 2029. The move highlights a $50 million increase in the original offering amount.

The company is expected to employ the net proceeds from the offering to redeem all of its outstanding 6% senior notes due 2023 under the indenture governing the 2023 notes. It also intends to use a portion of the proceeds for general corporate purposes.

## Valuation

Scotts Miracle-Gro's shares are up 61.1% over the trailing 12-month period. Over the past year, the Zacks sub-industry and sector are down 11% and up 0.7%, respectively.

The S&P 500 index is up 23.8% in the past year.

The stock is currently trading at 21.63X forward 12-month earnings, which compares to 17.33X for the Zacks sub-industry, 13.77X for the Zacks sector and 19.2X 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 18.64X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $117 price target reflects 22.67X 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 | 21.63 | 17.33 | 13.77 | 19.2 |
| | 5-Year High | 24.81 | 41.13 | 21.12 | 19.34 |
| | 5-Year Low | 13.73 | 10.16 | 9.76 | 15.17 |
| | 5-Year Median | 18.64 | 17.33 | 13.77 | 17.44 |
| EV/EBITDA TTM | Current | 25.06 | 6.26 | 9.54 | 12.12 |
| | 5-Year High | 30.3 | 20.9 | 18.35 | 12.86 |
| | 5-Year Low | 10.97 | 6.04 | 7.33 | 8.48 |
| | 5-Year Median | 13.77 | 9.19 | 10.57 | 10.67 |
| P/B TTM | Current | 8.62 | 1.13 | 2.36 | 4.55 |
| | 5-Year High | 18.03 | 2.48 | 3.54 | 4.55 |
| | 5-Year Low | 5.05 | 1.05 | 1.34 | 2.85 |
| | 5-Year Median | 7.81 | 1.38 | 2.18 | 3.61 |

As of 01/17/2020

## Industry Analysis **Zacks Industry Rank:** Bottom 2% (250 out of 254)


## Top Peers

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

## Industry Comparison Industry: Fertilizers

| | | | | Industry Peers | | |
|---|---|---|---|---|---|---|
| | **SMG** Neutral | **X Industry** | **S&P 500** | **CENT** Underperform | **RBGLY** Neutral | **SPB** Underperform |
| **VGM Score** | C | - | - | C | D | A |
| Market Cap | 6.23 B | 6.23 B | 24.65 B | 1.84 B | 58.26 B | 3.11 B |
| # of Analysts | 5 | 4 | 13 | 4 | 2 | 3 |
| Dividend Yield | 2.08% | 1.18% | 1.73% | 0.00% | 2.05% | 2.63% |
| **Value Score** | C | - | - | D | C | A |
| Cash/Price | 0.00 | 0.08 | 0.04 | 0.29 | NA | 0.20 |
| EV/EBITDA | 10.01 | 8.95 | 14.11 | 9.42 | NA | 12.70 |
| PEG Ratio | 2.11 | 2.47 | 2.08 | 2.85 | 9.84 | 0.94 |
| Price/Book (P/B) | 8.57 | 0.99 | 3.39 | 1.85 | NA | 1.82 |
| Price/Cash Flow (P/CF) | 18.17 | 8.57 | 13.81 | 12.74 | 15.77 | 6.39 |
| P/E (F1) | 22.24 | 18.83 | 19.19 | 20.48 | 19.67 | 17.56 |
| Price/Sales (P/S) | 1.97 | 1.33 | 2.69 | 0.77 | NA | 0.82 |
| Earnings Yield | 4.50% | 5.31% | 5.21% | 4.90% | 5.05% | 5.69% |
| Debt/Equity | 2.11 | 0.41 | 0.72 | 0.70 | NA | 1.30 |
| Cash Flow ($/share) | 6.15 | 3.48 | 6.94 | 2.58 | 1.04 | 9.99 |
| **Growth Score** | C | - | - | B | C | A |
| Hist. EPS Growth (3-5 yrs) | 5.30% | -12.13% | 10.56% | 30.26% | NA | NA |
| Proj. EPS Growth (F1/F0) | 12.26% | 14.08% | 7.57% | 0.31% | -3.47% | 27.04% |
| Curr. Cash Flow Growth | 15.63% | 42.96% | 14.73% | -4.06% | 30.07% | 64.31% |
| Hist. Cash Flow Growth (3-5 yrs) | 4.73% | -4.30% | 9.00% | 21.71% | 0.96% | 16.24% |
| Current Ratio | 1.68 | 1.62 | 1.24 | 4.69 | NA | 1.45 |
| Debt/Capital | 67.81% | 29.68% | 42.99% | 41.03% | NA | 56.48% |
| Net Margin | 14.59% | 8.50% | 11.14% | 3.89% | NA | 12.32% |
| Return on Equity | 41.87% | 6.49% | 17.16% | 9.26% | NA | 7.17% |
| Sales/Assets | 0.92 | 0.45 | 0.55 | 1.18 | NA | 0.64 |
| Proj. Sales Growth (F1/F0) | 4.46% | 3.93% | 4.16% | 1.93% | 0.60% | 1.42% |
| **Momentum Score** | D | - | - | C | F | B |
| Daily Price Chg | 0.83% | 0.00% | 0.27% | 1.11% | 0.15% | 0.19% |
| 1 Week Price Chg | 0.99% | -0.17% | 0.39% | 3.11% | -2.58% | -0.58% |
| 4 Week Price Chg | 8.23% | 1.25% | 2.95% | 6.55% | 4.02% | 2.33% |
| 12 Week Price Chg | 18.47% | 0.74% | 7.76% | 11.84% | 7.63% | 27.14% |
| 52 Week Price Chg | 63.57% | -17.33% | 22.29% | -15.52% | 7.00% | 18.74% |
| 20 Day Average Volume | 342,398 | 123,208 | 1,536,375 | 59,008 | 260,780 | 346,172 |
| (F1) EPS Est 1 week change | 0.00% | 0.00% | 0.00% | 0.00% | -1.76% | 0.00% |
| (F1) EPS Est 4 week change | 0.00% | -4.63% | 0.00% | 0.00% | -1.76% | -0.82% |
| (F1) EPS Est 12 week change | 2.16% | -11.61% | -0.40% | -15.53% | -6.18% | -6.12% |
| (Q1) EPS Est Mthly Chg | 0.00% | -16.13% | 0.00% | 0.00% | NA | 0.00% |

## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

## Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

## Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

## 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.

## Disclosures

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ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.