SCOTTS MIRACLE-GRO CO
Form 10-Q
February 05, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 27, 2014

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-11593

The Scotts Miracle-Gro Company
(Exact name of registrant as specified in its charter)

OHIO (State or other jurisdiction of incorporation or organization)	31-1414921 (I.R.S. Employer Identification No.)
14111 SCOTTSLAWN ROAD, MARYSVILLE, OHIO (Address of principal executive offices)	43041 (Zip Code)

(937) 644-0011
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date:

Class	Outstanding at February 2, 2015
Common Shares, $0.01 stated value, no par value	60,849,013 Common Shares

1

Table of Contents

THE SCOTTS MIRACLE-GRO COMPANY
INDEX

		PAGE NO.
PART I. FINANCIAL INFORMATION:		
Item 1.	Financial Statements	
	Condensed Consolidated Statements of Operations — Three months ended December 27, 2014 and December 28, 2013	3
	Condensed Consolidated Statements of Comprehensive Income (Loss) — Three months ended December 27, 2014 and December 28, 2013	4
	Condensed Consolidated Statements of Cash Flows — Three months ended December 27, 2014 and December 28, 2013	5
	Condensed Consolidated Balance Sheets — December 27, 2014, December 28, 2013 and September 30, 2014	6
	Notes to Condensed Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	33
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	40
Item 4.	Controls and Procedures	41
PART II. OTHER INFORMATION:		
Item 1.	Legal Proceedings	42
Item 1A.	Risk Factors	42
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	43
Item 6.	Exhibits	44
Signatures		45
Index to Exhibits		46

Table of Contents

PART I—FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
THE SCOTTS MIRACLE-GRO COMPANY
Condensed Consolidated Statements of Operations
(In millions, except per common share data)
(Unaudited)

	THREE MONTHS ENDED	
	DECEMBER 27, 2014	DECEMBER 28, 2013
Net sales	$216.2	$ 189.6
Cost of sales	186.9	155.7
Gross profit	29.3	33.9
Operating expenses:		
Selling, general and administrative	126.9	124.3
Impairment, restructuring and other	9.6	0.3
Other income, net	(1.2)	(1.0)
Loss from operations	(106.0)	(89.7)
Interest expense	9.7	13.9
Loss from continuing operations before income taxes	(115.7)	(103.6)
Income tax benefit from continuing operations	(41.7)	(37.9)
Loss from continuing operations	(74.0)	(65.7)
Income from discontinued operations, net of tax	—	0.1
Net loss	$(74.0)	$ (65.6)
Net income attributable to noncontrolling interest	$(0.6)	$ —
Net loss attributable to controlling interest	$(74.6)	$ (65.6)
Basic loss per common share:		
Loss from continuing operations	$(1.23)	$ (1.06)
Income from discontinued operations	—	—
Basic loss per common share	$(1.23)	$ (1.06)
Weighted-average common shares outstanding during the period	60.8	62.1
Diluted loss per common share:		
Loss from continuing operations	$(1.23)	$ (1.06)
Income from discontinued operations	—	—
Diluted loss per common share	$(1.23)	$ (1.06)
Weighted-average common shares outstanding during the period plus dilutive potential common shares	60.8	62.1
Dividends declared per common share	$0.450	$ 0.438

See notes to condensed consolidated financial statements.

Table of Contents

THE SCOTTS MIRACLE-GRO COMPANY
Condensed Consolidated Statements of Comprehensive Income (Loss)
(In millions)
(Unaudited)

	THREE MONTHS ENDED	
	DECEMBER 27, 2014	DECEMBER 28, 2013
Net loss	$(74.0)	$(65.6)
Other comprehensive income (loss), net of tax:		
Net foreign currency translation adjustment	(3.0)	(1.4)
Net unrealized gains (loss) on derivative instruments, net of tax of $(0.7) and $0.2, respectively	(1.1)	0.4
Reclassification of net unrealized loss on derivatives to net income, net of tax of $0.6 and $1.9, respectively	1.0	3.1
Net unrealized (loss) in pension and other post-retirement benefits, net of tax of $0.0 and $0.2, respectively	—	(0.3)
Reclassification of net pension and post-retirement benefit income (loss) to net income, net of tax of $0.5 and $0.5, respectively	0.8	0.8
Total other comprehensive (loss) income	(2.3)	2.6
Comprehensive loss	$(76.3)	$(63.0)

See notes to condensed consolidated financial statements.

Table of Contents

THE SCOTTS MIRACLE-GRO COMPANY
Condensed Consolidated Statements of Cash Flows
(In millions)
(Unaudited)

	THREE MONTHS ENDED	
	DECEMBER 27, 2014	DECEMBER 28, 2013
OPERATING ACTIVITIES		
Net loss	$(74.0)	$(65.6)
Adjustments to reconcile net income to net cash provided by operating activities:		
Impairment, restructuring and other	3.6	—
Share-based compensation expense	2.1	1.8
Depreciation	12.5	13.0
Amortization	3.7	3.1
Loss on sale of assets	—	0.1
Changes in assets and liabilities, net of acquired businesses:		
Accounts receivable	148.9	145.5
Inventories	(301.2)	(278.9)
Prepaid and other assets	(6.8)	(6.9)
Accounts payable	33.0	98.5
Other current liabilities	(93.8)	(88.1)
Restructuring reserves	2.1	(4.2)
Other non-current items	5.8	1.7
Other, net	(2.9)	(0.2)
Net cash used in operating activities	(267.0)	(180.2)
INVESTING ACTIVITIES		
Investments in property, plant and equipment	(14.5)	(43.4)
Investment in acquired business, net of cash acquired	(11.1)	(60.0)
Net cash used in investing activities	(25.6)	(103.4)
FINANCING ACTIVITIES		
Borrowings under revolving and bank lines of credit	539.6	508.3
Repayments under revolving and bank lines of credit	(167.1)	(197.1)
Financing and issuance fees	—	(6.1)
Dividends paid	(27.4)	(27.3)
Purchase of common shares	(14.8)	(8.5)
Excess tax benefits from share-based payment arrangements	0.5	2.8
Cash received from the exercise of stock options	6.2	5.1
Net cash provided by financing activities	337.0	277.2
Effect of exchange rate changes on cash	(3.6)	1.2
Net increase (decrease) in cash and cash equivalents	40.8	(5.2)
Cash and cash equivalents, beginning of period	89.3	129.8
Cash and cash equivalents, end of period	$130.1	$124.6
SUPPLEMENTAL CASH FLOW INFORMATION		
Interest paid	$(11.2)	$(11.6)
Income taxes paid	$(8.6)	$(2.2)

See notes to condensed consolidated financial statements.

5

Table of Contents

THE SCOTTS MIRACLE-GRO COMPANY
Condensed Consolidated Balance Sheets
(In millions, except stated value per share)
(Unaudited)

	DECEMBER 27, 2014	DECEMBER 28, 2013	SEPTEMBER 30, 2014
ASSETS			
Current assets:			
Cash and cash equivalents	$ 130.1	$ 124.6	$ 89.3
Accounts receivable, less allowances of $6.8, $8.8 and $7.5, respectively	185.4	158.2	224.0
Accounts receivable pledged	—	9.3	113.7
Inventories	682.8	605.7	385.1
Prepaid and other current assets	127.6	117.9	122.9
Total current assets	1,125.9	1,015.7	935.0
Property, plant and equipment, net of accumulated depreciation of $606.1, $586.6 and $597.2, respectively	434.4	447.5	437.0
Goodwill	364.3	335.0	350.9
Intangible assets, net	308.9	320.0	302.7
Other assets	31.7	41.2	32.7
Total assets	$ 2,265.2	$ 2,159.4	$ 2,058.3
LIABILITIES AND SHAREHOLDERS’ EQUITY			
Current liabilities:			
Current portion of debt	$ 36.6	$ 229.7	$ 91.9
Accounts payable	220.0	230.8	193.3
Other current liabilities	165.3	188.4	259.5
Total current liabilities	421.9	648.9	544.7
Long term debt	1,133.3	652.3	692.4
Other liabilities	249.1	236.9	254.0
Total liabilities	1,804.3	1,538.1	1,491.1
Contingencies (note 11)			
Shareholders’ equity:			
Common shares and capital in excess of $.01 stated value per share; 60.7, 62.2 and 60.7 shares issued and outstanding, respectively	399.0	394.2	395.3
Retained earnings	534.6	610.2	636.9
Treasury shares, at cost; 7.5, 6.0 and 7.4 shares, respectively	(398.2)	(307.9)	(392.3)
Accumulated other comprehensive loss	(88.6)	(75.2)	(86.2)
Total shareholders’ equity - controlling interest	446.8	621.3	553.7
Noncontrolling interest	14.1	—	13.5
Total equity	$ 460.9	$ 621.3	$ 567.2
Total liabilities and shareholders’ equity	$ 2,265.2	$ 2,159.4	$ 2,058.3

See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Scotts Miracle-Gro Company (“Scotts Miracle-Gro” or “Parent”) and its subsidiaries (collectively, together with Scotts Miracle-Gro, the “Company”) are engaged in the manufacturing, marketing and sale of consumer branded products for lawn and garden care. The Company’s primary customers include home centers, mass merchandisers, warehouse clubs, large hardware chains, independent hardware stores, nurseries, garden centers and food and drug stores. The Company’s products are sold primarily in North America and the European Union. The Company also operates the Scotts LawnService® business, which provides residential and commercial lawn care, tree and shrub care and limited pest control services in the United States.

Organization and Basis of Presentation

The Company’s unaudited condensed consolidated financial statements for the three months ended December 27, 2014 and December 28, 2013 are presented in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The condensed consolidated financial statements include the accounts of Scotts Miracle-Gro and its subsidiaries. All intercompany transactions and accounts have been eliminated in consolidation. The Company’s consolidation criteria are based on majority ownership (as evidenced by a majority voting interest in the entity) and an objective evaluation and determination of effective management control. AeroGrow International, Inc. (“AeroGrow”), in which the Company owns controlling interest, is consolidated with the equity owned by other shareholders shown as noncontrolling interest in the consolidated balance sheets, and the other shareholders' portion of net earnings and other comprehensive income is shown as net earnings or comprehensive income attributable to noncontrolling interest in the consolidated statement of operations and consolidated statements of comprehensive income (loss), respectively. In the opinion of management, interim results reflect all normal and recurring adjustments and are not necessarily indicative of results for a full year.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted or condensed pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, this report should be read in conjunction with Scotts Miracle-Gro’s Annual Report on Form 10-K for the fiscal year ended September 30, 2014 (the “2014 Annual Report”), which includes a complete set of footnote disclosures, including the Company’s significant accounting policies.

The Company’s Condensed Consolidated Balance Sheet at December 27, 2014 has been derived from the Company’s audited Consolidated Balance Sheet at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported and related disclosures. Although these estimates are based on management’s best knowledge of current events and actions the Company may undertake in the future, actual results ultimately may differ from the estimates.

Long-lived Assets

The Company had noncash investing activities of $3.0 million and $2.0 million representing unpaid liabilities incurred during the three months ended December 27, 2014 and December 28, 2013, respectively, to acquire property, plant and equipment.

RECENT ACCOUNTING PRONOUNCEMENTS

Revenue Recognition from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers. This guidance requires companies to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in amounts that reflect the consideration to which a company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The provisions are effective for the Company's financial statements for the fiscal year

beginning October 1, 2017. The standard allows for either a full retrospective or a modified retrospective transition method. The Company is currently evaluating the impact of this standard on its consolidated results of operations, financial position and cash flows.

Table of Contents

Discontinued Operations Reporting

In April 2014, the FASB issued an accounting standard update that amends the accounting guidance related to discontinued operations. This amendment defines discontinued operations as a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has or will have a major effect on an entity's operations and financial results. This amendment also introduces new disclosures for disposals that do not meet the criteria of discontinued operations. The provisions are effective for fiscal years beginning after December 15, 2014 and apply to new disposals and new classifications of disposal groups as held for sale after the effective date. The adoption of the amended guidance impacts presentation and disclosure and will not have a significant impact on the Company's consolidated financial position, results of operations or cash flows.

Going Concern

In August 2014, the FASB issued a new accounting standard that requires management to assess if there is substantial doubt about an entity's ability to continue as a going concern for each annual and interim period. If conditions or events give rise to substantial doubt, disclosures are required. The new accounting standard will be effective as of December 31, 2016 and is not expected to have an impact on the Company's financial statement disclosures.

NOTE 2. DISCONTINUED OPERATIONS

In March 2014, the Company completed the sale of its U.S. and Canadian wild bird food business, including intangible assets, certain on-hand inventory and fixed assets, for $4.1 million in cash and an estimated $1.0 million in future earn-out payments. As a result, effective in the second quarter of fiscal 2014, the Company classified its results of operations for all periods presented to reflect the wild bird food business as a discontinued operation. In addition, in the third quarter of fiscal 2014, the Company received $3.1 million for the sale of the remaining wild bird food manufacturing facilities resulting in a gain of $1.2 million.

The following table summarizes the results of the wild bird food business within discontinued operations for the periods presented:

	THREE MONTHS ENDED	
	DECEMBER 27, 2014	DECEMBER 28, 2013
	(In millions)	
Net sales	$—	$ 6.8
Operating costs	—	6.6
Gain on sale of assets	—	—
Income from discontinued operations before income taxes	—	0.2
Income tax expense from discontinued operations	—	0.1
Income from discontinued operations, net of tax	$—	$ 0.1

NOTE 3. ACQUISITIONS

Fiscal 2015

On October 16, 2014, Scotts LawnService® acquired the assets of Action Pest Control, Inc. ("Action Pest"), a residential and commercial pest control provider in the Midwest, for $21.7 million. Action Pest provides residential and commercial pest control services to homeowners and businesses throughout Indiana, Kentucky, and Illinois. This transaction provides Scotts LawnService® an entry into the pest control market, which is part of the segment's long-term growth strategy. Included in the purchase price of $21.7 million is non-cash investing activity of $14.2 million representing the deferral of a portion of the purchase price into subsequent fiscal periods. The preliminary valuation of acquired assets included finite-lived identifiable intangible assets of $6.0 million and tax deductible goodwill of $13.6 million. Identifiable intangible assets included tradename, customer relationships and non-compete agreements with useful lives ranging between 5 to 12 years. The estimated fair values of the identifiable intangible assets were determined using an income-based approach, which includes market participant expectations of cash flows that an asset will generate over the remaining useful life discounted to present value using an appropriate rate of return. The Company expects to complete the valuation before the end of fiscal 2015. Net sales for Action Pest included in the Scotts LawnService® segment for the three months ended December 27, 2014 were $1.9 million.

In December 2014, the Company completed an acquisition within its growing media business within the Global Consumer segment to expand its naturals product offerings for an estimated purchase price of $7.1 million. Included in the purchase price of $7.1 million is non-cash investing activity of $3.5 million representing the deferral of a portion of the purchase price into subsequent fiscal periods.

Table of Contents

On January 30, 2015, the Company completed an acquisition within its growing media business within the Global Consumer segment to expand its growing media distribution assets for an estimated purchase price of $12.6 million.

Fiscal 2014

During the three months ended September 30, 2014, the Company obtained control of the operations of AeroGrow through its increased involvement, influence, and working capital loan of $4.5 million provided in July 2014. AeroGrow is a developer, marketer, direct-seller, and wholesaler of advanced indoor garden systems designed for consumer use in gardening, cooking, healthy eating, and home and office décor markets. AeroGrow operates primarily in the United States and Canada, as well as select countries in Europe, Asia and Australia. The preliminary valuation of acquired assets included finite-lived identifiable intangible assets of $13.7 million, and goodwill of $11.6 million. Identifiable intangible assets included tradename and customer relationships with useful lives ranging between 9 to 20 years. The estimated fair values of the identifiable intangible assets were determined using an income-based approach, which includes market participant expectations of cash flows that an asset will generate over the remaining useful life discounted to present value using an appropriate rate of return. The Company expects to complete the valuation before the end of fiscal 2015. Net sales for AeroGrow included in the Global Consumer segment for the three months ended December 27, 2014 were $11.2 million.

The Company completed an acquisition of the assets of the U.K. based Solus Garden and Leisure Limited (“Solus”) in the fourth quarter of fiscal 2014 within its Global Consumer segment for $7.4 million, $1.1 million of which was paid in cash and $6.3 million of which was paid through the forgiveness of outstanding accounts receivable owed by Solus to the Company. Solus is a supplier of garden and leisure products and offers a diverse mix of brands.

On September 30, 2014, Scotts Miracle-Gro's wholly-owned subsidiary, Scotts Canada Ltd., acquired Fafard & Brothers Ltd. (“Fafard”) for $59.8 million. Fafard is a Canadian based producer of peat moss and growing media products for the consumer and professional markets, including peat-based and bark-based mixes, composts and premium soils. The acquisition of Fafard increases the Company's presence within Canada as Fafard serves customers primarily across Ontario, Quebec and New Brunswick. The preliminary valuation of acquired assets included working capital of $18.0 million, property, plant, and equipment of $23.7 million, finite-lived identifiable intangible assets of $13.6 million, and tax deductible goodwill of $6.0 million. Working capital included accounts receivable of $5.2 million, inventory of $17.3 million, and accounts payable of $4.5 million. Identifiable intangible assets included tradename, customer relationships, non-compete agreements, and peat harvesting rights with useful lives ranging between 5 to 25 years. The estimated fair values of the identifiable intangible assets were determined using an income-based approach, which includes market participant expectations of cash flows that an asset will generate over the remaining useful life discounted to present value using an appropriate rate of return. The Company expects to complete the valuation before the end of fiscal 2015. Included in the purchase price of Fafard is $7.1 million of contingent consideration, the payment of which will depend on the performance of the business over the next two years. Net sales for Fafard included in the Global Consumer segment for the three months ended December 27, 2014 were $7.8 million.

The condensed consolidated financial statements include the results of operations for these business combinations from the date of each acquisition.

NOTE 4. IMPAIRMENT, RESTRUCTURING AND OTHER

Activity described herein is classified within the “Impairment, restructuring and other” lines in the Condensed Consolidated Statements of Operations.

The following table details impairment, restructuring and other for the periods presented:

	THREE MONTHS ENDED	
	DECEMBER 27, 2014	DECEMBER 28, 2013
	(In millions)	
Restructuring and other	$9.6	$ 0.3
Goodwill and intangible asset impairments	—	—
Total impairment, restructuring and other	$9.6	$ 0.3

9

The following table summarizes the activity related to liabilities associated with the restructuring and other charges during the three months ended December 27, 2014 (in millions):

Amounts reserved for restructuring and other charges at September 30, 2014	$16.0
Restructuring and other charges	9.6
Payments and other	(7.7)
Amounts reserved for restructuring and other charges at December 27, 2014	$17.9

Included in the restructuring reserves as of December 27, 2014 is $3.7 million that is classified as long-term. Payments against the long-term reserves will be incurred as the employees covered by the restructuring plan retire. The remaining amounts reserved will continue to be paid out over the course of the next twelve months.

During the three months ended December 27, 2014, the Company recognized $9.6 million in restructuring costs related to termination benefits provided to U.S. executives and international personnel as part of a continuation of the fiscal 2014 restructuring initiative to eliminate layers and streamline decision making. The restructuring charge includes $3.6 million of costs related to the acceleration of equity compensation expense. Included within the restructuring charge incurred above was $1.0 million for the Scotts LawnService® segment, $2.0 million for the Global Consumer segment, and $6.6 million for Corporate & Other. Costs incurred to date since the inception of the fiscal 2014 initiative are $11.5 million for Global Consumer, $1.4 million for Scotts LawnService®, and $9.2 million for Corporate & Other. The Company expects to complete its fiscal 2014 restructuring initiative in the second quarter of fiscal 2015.

NOTE 5. INVENTORIES

Inventories consisted of the following for each of the periods presented:

	DECEMBER 27, 2014	DECEMBER 28, 2013	SEPTEMBER 30, 2014
	(In millions)		
Finished goods	$476.4	$412.4	$ 217.5
Work-in-process	60.5	49.8	46.2
Raw materials	145.9	143.5	121.4
Total inventories	$682.8	$605.7	$ 385.1

Adjustments to reflect inventories at net realizable values were $19.1 million at December 27, 2014, $19.4 million at December 28, 2013 and $18.4 million at September 30, 2014.

NOTE 6. MARKETING AGREEMENT

The Company is Monsanto’s exclusive agent for the marketing and distribution of consumer Roundup® herbicide products (with additional rights to new products containing glyphosate or other similar non-selective herbicides) in the consumer lawn and garden market within the United States and other specified countries, including Australia, Austria, Belgium, Canada, France, Germany, the Netherlands and the United Kingdom. Under the terms of the marketing agreement the Company has entered into with Monsanto (the “Marketing Agreement”), the Company is entitled to receive an annual commission from Monsanto as consideration for the performance of the Company’s duties as agent. The annual gross commission under the Marketing Agreement is calculated as a percentage of the actual earnings before interest and income taxes of the consumer Roundup® business in the markets covered by the Marketing Agreement and is based on the achievement of two earnings thresholds, as defined in the Marketing Agreement. The Marketing Agreement also requires the Company to make annual payments to Monsanto as a contribution against the overall expenses of the consumer Roundup® business. The annual contribution payment is defined in the Marketing Agreement as $20 million.

In consideration for the rights granted to the Company under the Marketing Agreement for North America, the Company was required to pay a marketing fee of $32 million to Monsanto. The Company has deferred this amount on the basis that the payment will provide a future benefit through commissions that will be earned under the Marketing Agreement. The economic useful life over which the marketing fee is being amortized is 20 years, with a remaining

amortization period of less than four years as of December 27, 2014.

Under the terms of the Marketing Agreement, the Company performs certain functions, primarily manufacturing conversion, distribution and logistics, and selling and marketing support, on behalf of Monsanto in the conduct of the consumer Roundup® business. The actual costs incurred for these activities are charged to and reimbursed by Monsanto. The Company records costs

Table of Contents

incurred under the Marketing Agreement for which the Company is the primary obligor on a gross basis, recognizing such costs in “Cost of sales” and the reimbursement of these costs in “Net sales,” with no effect on gross profit dollars or net income.

The gross commission earned under the Marketing Agreement, the contribution payments to Monsanto and the amortization of the initial marketing fee paid to Monsanto are included in the calculation of net sales in the Company’s Consolidated Statements of Operations. The elements of the net commission and reimbursements earned under the Marketing Agreement and included in “Net sales” are as follows:

	THREE MONTHS ENDED	
	DECEMBER 27, 2014	DECEMBER 28, 2013
	(In millions)	
Gross commission	$—	$ —
Contribution expenses	(5.0)	(5.0)
Amortization of marketing fee	(0.2)	(0.2)
Net commission income	(5.2)	(5.2)
Reimbursements associated with Marketing Agreement	17.3	15.1
Total net sales associated with Marketing Agreement	$12.1	$ 9.9

The Marketing Agreement has no definite term except as it relates to the European Union countries (the “EU term”). The EU term extends through September 30, 2015. Thereafter, the Marketing Agreement provides that the parties may agree to renew the EU term for an additional three years.

The Marketing Agreement provides Monsanto with termination rights upon an event of default (as defined in the Marketing Agreement) by the Company, a change in control of Monsanto or the sale of the consumer Roundup® business. The Marketing Agreement provides the Company with termination rights in certain circumstances, including an event of default by Monsanto or the sale of the consumer Roundup® business. Unless Monsanto terminates the Marketing Agreement due to an event of default by the Company, Monsanto is required to pay a termination fee to the Company that varies by program year. The termination fee is calculated as a percentage of the value of the Roundup® business exceeding a certain threshold, but in no event will the termination fee be less than $16 million. If Monsanto were to terminate the Marketing Agreement for cause, the Company would not be entitled to any termination fee. Monsanto may also be able to terminate the Marketing Agreement within a given region, including North America, without paying a termination fee if unit volume sales to consumers in that region decline: (1) over a cumulative three-fiscal-year period; or (2) by more than 5% for each of two consecutive years. If the Marketing Agreement was terminated, the Company would also lose all, or a substantial portion, of the significant source of earnings and overhead expense absorption the Marketing Agreement provides.

Under the Marketing Agreement, Monsanto must provide the Company with notice of any proposed sale of the consumer Roundup® business, allow the Company to participate in the sale process and negotiate in good faith with the Company with respect to any such proposed sale. In the event the Company acquires the consumer Roundup® business in such a sale, the Company would receive as a credit against the purchase price the amount of the termination fee that would have been paid to the Company if Monsanto had exercised its right to terminate the Marketing Agreement in connection with a sale to another party. If Monsanto decides to sell the consumer Roundup® business to another party, the Company must let Monsanto know whether the Company intends to terminate the Marketing Agreement and forfeit any right to a termination fee.

Table of Contents

NOTE 7. DEBT

The components of long-term debt are as follows:

	DECEMBER 27, 2014	DECEMBER 28, 2013	SEPTEMBER 30, 2014
	(In millions)		
Credit facility – Revolving loans	$922.9	$447.4	$481.8
Senior Notes – 7.25%	—	200.0	—
Senior Notes – 6.625%	200.0	200.0	200.0
Master Accounts Receivable Purchase Agreement	—	7.4	84.0
Other	47.0	27.2	18.5
	1,169.9	882.0	784.3
Less current portions	36.6	229.7	91.9
Total long-term debt	$1,133.3	$652.3	$692.4

On January 15, 2014, the Company redeemed all of its outstanding $200.0 million aggregate principal amount of 7.25% senior notes due 2018 (the “7.25% Senior Notes”) paying a redemption price of $214.5 million, which included $7.25 million of accrued and unpaid interest, $7.25 million of call premium, and $200.0 million for outstanding principal amount. The $7.25 million call premium charge was recognized within the “Costs related to refinancing” line on the Condensed Consolidated Statement of Operations in the Company's second quarter of fiscal 2014. Additionally, the Company had $3.5 million in unamortized bond discount and issuance costs associated with the 7.25% Senior Notes that were written-off and recognized in the “Costs related to refinancing” line on the Condensed Consolidated Statement of Operations in the Company's second quarter of fiscal 2014.

On December 20, 2013, the Company entered into a third amended and restated senior secured credit agreement (“credit facility”), providing the Company and certain of its subsidiaries with a five-year senior secured revolving loan facility in the aggregate principal amount of up to $1.7 billion. The credit facility also provides the Company with the right to seek to increase the credit facility by an aggregate amount of up to $450.0 million, subject to certain specified conditions, including approval from lenders.

The terms of the credit facility include customary representations and warranties, affirmative and negative covenants, financial covenants and events of default. The proceeds of borrowings on the credit facility may be used: (i) to finance working capital requirements and other general corporate purposes of the Company and its subsidiaries; and (ii) to refinance the amounts outstanding under the previous credit agreement. The Company may use the credit facility for issuance of up to $75 million of letters of credit and for borrowings under swing line loans of up to $100 million. The credit facility will terminate on December 20, 2018.

Under the terms of the credit facility, loans made bear interest, at the Company’s election, at a rate per annum equal to either the ABR or LIBOR (both as defined in the credit facility) plus the applicable margin. The credit facility is guaranteed by substantially all of the Company's domestic subsidiaries. The credit facility is secured by (i) a perfected first priority security interest in all of the accounts receivable, inventory and equipment of the Company and those of the Company’s domestic subsidiaries that are parties to the third amended and restated guarantee and collateral agreement and (ii) the pledge of all of the capital stock of the Company’s domestic subsidiaries that are parties to the third amended and restated guarantee and collateral agreement.

As of December 27, 2014, there was $753.1 million of availability under the credit facility, including availability for letters of credit. At December 27, 2014, the Company had letters of credit in the aggregate face amount of $24.0 million outstanding under the credit facility.

The credit facility contains, among other obligations, an affirmative covenant regarding the Company’s leverage ratio, calculated as average total indebtedness, relative to the Company’s earnings before interest, taxes, depreciation and amortization (“EBITDA”), as adjusted pursuant to the terms of the credit facility (“Adjusted EBITDA”). Under the terms of the credit facility, the maximum leverage ratio was 4.00 as of December 27, 2014. The Company’s leverage ratio was 2.41 at December 27, 2014. The new credit facility also includes an affirmative covenant regarding its interest

coverage ratio. The interest coverage ratio is calculated as Adjusted EBITDA divided by interest expense, as described in the credit facility, and excludes costs related to refinancings. Under the terms of the credit facility, the minimum interest coverage ratio was 3.50 for the twelve months ended December 27, 2014. The Company's interest coverage ratio was 10.09 for the twelve months ended December 27, 2014. The Company may make restricted payments (as defined in the third amended and restated credit agreement); provided that if after giving effect to any such restricted payment the leverage ratio is not greater than 3.00. Otherwise the Company may only make

Table of Contents

restricted payments in an aggregate amount for each fiscal year not to exceed the amount set forth for such fiscal year ($150.0 million for 2015 and $175.0 million for 2016 and in each fiscal year thereafter).

The Company accounts for the sale of receivables under the Master Accounts Receivable Purchase Agreement ("MARP Agreement") as short-term debt and continues to carry the receivables on its Consolidated Balance Sheet, primarily as a result of the Company's right to repurchase receivables sold. Refer to "NOTE 10. DEBT" in the 2014 Annual Report for more information regarding the MARP Agreement. There were no borrowings under the MARP Agreement as of December 27, 2014 and $7.4 million in borrowings as of December 28, 2013. There were no receivables pledged as collateral as of December 27, 2014 and the carrying value of the receivables pledged as collateral was $9.3 million as of December 28, 2013. As of December 27, 2014, there was $29.6 million of availability under the MARP Agreement.

Estimated Fair Values

A description of the methods and assumptions used to estimate the fair values of the Company's debt instruments is as follows:

Credit Facility

The interest rate currently available to the Company fluctuates with the applicable LIBOR rate, prime rate or Federal Funds Effective Rate and thus the carrying value is a reasonable estimate of fair value. The fair value measurement for the credit facility was classified in Level 2 of the fair value hierarchy.

6.625% Senior Notes

The fair value of Scotts Miracle-Gro's 6.625% senior notes due 2020 (the "6.625% Senior Notes") can be determined based on the trading of the 6.625% Senior Notes in the open market. The difference between the carrying value and the fair value of the 6.625% Senior Notes represents the premium or discount on that date. Based on the trading value on or around December 27, 2014, December 28, 2013 and September 30, 2014, the fair value of the 6.625% Senior Notes was approximately $210.5 million, $216.2 million and $212.5 million, respectively. The fair value measurement for the 6.625% Senior Notes was classified in Level 1 of the fair value hierarchy.

Accounts Receivable Pledged

The interest rate on the short-term debt associated with accounts receivable pledged under the MARP Agreement fluctuates with the applicable LIBOR rate and thus the carrying value is a reasonable estimate of fair value. The fair value measurement for the MARP Agreement was classified in Level 2 of the fair value hierarchy.

Interest Rate Swap Agreements

The Company has outstanding interest rate swap agreements with major financial institutions that effectively converts a portion of the Company's variable-rate debt to a fixed rate. The swap agreements had a total U.S. dollar equivalent notional amount of $1,300.0 million at December 27, 2014, $1,100.0 million at December 28, 2013, and $1,300.0 million at September 30, 2014. Interest payments made between the effective date and expiration date are hedged by the swap agreements, except as noted below. The notional amount, effective date, expiration date and rate of each of these swap agreements are shown in the table below.

Notional Amount (in millions)		Effective Date (a)	Expiration Date	Fixed Rate
$50		2/14/2012	2/14/2016	3.78%
150	(b)	2/7/2012	5/7/2016	2.42%
150	(c)	11/16/2009	5/16/2016	3.26%
50	(b)	2/16/2010	5/16/2016	3.05%
100	(b)	2/21/2012	5/23/2016	2.40%
150	(c)	12/20/2011	6/20/2016	2.61%
50	(d)	12/6/2012	9/6/2017	2.96%
200		2/7/2014	11/7/2017	1.28%
150	(b)	2/7/2017	5/7/2019	2.12%
50	(c)	2/7/2017	5/7/2019	2.25%
200	(c)	12/20/2016	6/20/2019	2.12%

(a) The effective date refers to the date on which interest payments were, or will be, first hedged by the applicable swap agreement.

Table of Contents

(b) Interest payments made during the three-month period of each year that begins with the month and day of the effective date are hedged by the swap agreement.

(c) Interest payments made during the six-month period of each year that begins with the month and day of the effective date are hedged by the swap agreement.

(d) Interest payments made during the nine-month period of each year that begins with the month and day of the effective date are hedged by the swap agreement.

Weighted Average Interest Rate

The weighted average interest rates on the Company's debt were 4.3% and 8.1% for the three months ended December 27, 2014 and December 28, 2013, respectively. The weighed average interest rate for the three months ended December 28, 2013 included hedge ineffectiveness of $2.0 million related to interest rate swap agreements, which was recorded to interest expense, in conjunction with entering into the credit facility.

NOTE 8. RETIREMENT AND RETIREE MEDICAL PLANS

The following summarizes the components of net periodic benefit cost for the retirement and retiree medical plans sponsored by the Company:

	THREE MONTHS ENDED					
	DECEMBER 27, 2014			DECEMBER 28, 2013		
	U.S. Pension	International Pension	U.S. Medical	U.S. Pension	International Pension	U.S. Medical
	(In millions)					
Service cost	$—	$0.3	$0.1	$—	$0.5	$0.1
Interest cost	1.0	1.9	0.3	1.1	3.2	0.3
Expected return on plan assets	(1.3)	(2.3)	—	(1.3)	(3.6)	—
Net amortization	0.8	0.5	—	1.0	0.5	—
Net periodic benefit cost	$0.5	$0.4	$0.4	$0.8	$0.6	$0.4

NOTE 9. SHAREHOLDERS' EQUITY

During the three months ended December 27, 2014, Scotts Miracle-Gro repurchased 0.2 million of its common shares (the "Common Shares") for $14.8 million. These repurchases were made pursuant to the $500 million share repurchase program approved by the Scotts Miracle-Gro Board of Directors in August 2014. The program allows for repurchases of Common Shares over a five-year period starting November 1, 2014 through September 30, 2019.

Share-Based Awards

The following is a summary of the share-based awards granted during the periods indicated:

	THREE MONTHS ENDED	
	DECEMBER 27, 2014	DECEMBER 28, 2013
Employees		
Restricted stock units	—	31,032
Board of Directors		
Deferred stock units	1,355	1,035
Total share-based awards	1,355	32,067
Aggregate fair value at grant dates (in millions)	$0.1	$1.9

Table of Contents

Total share-based compensation recognized was as follows for the periods indicated:

	THREE MONTHS ENDED	
	DECEMBER 27, 2014	DECEMBER 28, 2013
	(In millions)	
Share-based compensation	$2.1	$1.8
Tax benefit recognized	0.8	0.7

As of December 27, 2014 the equity attributable to noncontrolling interest was $14.1 million compared to $13.5 million as of September 30, 2014. The $0.6 million change is due to the net earnings from the Company's investment in AeroGrow.

Subsequent to December 27, 2014, Scotts Miracle-Gro awarded performance share units, restricted stock units, deferred stock units, and stock options covering 0.5 million Common Shares to employees and members of the Board of Directors with an estimated fair value of $12.2 million on the date of the grant.

NOTE 10. INCOME TAXES

The effective tax rate related to continuing operations for the three months ended December 27, 2014 was 36.0%, compared to 36.6% for the three months ended December 28, 2013. The effective tax rate used for interim reporting purposes is based on management’s best estimate of factors impacting the effective tax rate for the full fiscal year. An allocation of the income tax expense has been separately determined to report the discontinued operations, net of tax. There can be no assurance that the effective tax rate estimated for interim financial reporting purposes will approximate the effective tax rate determined at fiscal year end.

Scotts Miracle-Gro or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. With few exceptions, which are discussed further below, the Company is no longer subject to examination by these tax authorities for fiscal years prior to 2011. The Company is currently under examination by the Internal Revenue Service and certain foreign and U.S. state and local tax authorities. The U.S. federal examination is limited to fiscal year 2011. Regarding the foreign jurisdictions, an audit was completed during the first quarter of fiscal 2015 in France covering fiscal years 2010 through 2012 with no impact to the consolidated financial statements. In regard to the multiple U.S., state and local audits, the tax periods under examination are limited to fiscal years 2009 through 2012. In addition to the aforementioned audits, certain other tax deficiency notices and refund claims for previous years remain unresolved.

The Company anticipates that few of its open and active audits will be resolved within the next 12 months. The Company is unable to make a reasonably reliable estimate as to when or if cash settlements with taxing authorities may occur. Although audit outcomes and the timing of audit payments are subject to significant uncertainty, the Company does not anticipate that the resolution of these tax matters or any events related thereto will result in a material change to its consolidated financial position, results of operations or cash flows.

NOTE 11. CONTINGENCIES

Management regularly evaluates the Company’s contingencies, including various lawsuits and claims which arise in the normal course of business, product and general liabilities, workers’ compensation, property losses and other liabilities for which the Company is self-insured or retains a high exposure limit. Self-insurance reserves are established based on actuarial loss estimates for specific individual claims plus actuarially estimated amounts for incurred but not reported claims and adverse development factors applied to existing claims. Legal costs incurred in connection with the resolution of claims, lawsuits and other contingencies generally are expensed as incurred. In the opinion of management, the assessment of contingencies is reasonable and related reserves, in the aggregate, are adequate; however, there can be no assurance that final resolution of these matters will not have a material effect on the Company’s financial condition, results of operations or cash flows.

Regulatory Matters

At December 27, 2014, $5.8 million was accrued in the “Other liabilities” line in the Consolidated Balance Sheet for environmental actions, the majority of which are for site remediation. The amounts accrued are believed to be adequate to cover such known environmental exposures based on current facts and estimates of likely outcomes. Although it is reasonably possible that the costs to resolve such known environmental exposures will exceed the amounts accrued, any variation from accrued amounts is not expected to be material.

Table of Contents

Other

The Company has been named as a defendant in a number of cases alleging injuries that the lawsuits claim resulted from exposure to asbestos-containing products, apparently based on the Company's historic use of vermiculite in certain of its products. In many of these cases, the complaints are not specific about the plaintiffs' contacts with the Company or its products. The cases vary but complaints in these cases generally seek unspecified monetary damages (actual, compensatory, consequential and punitive) from multiple defendants. The Company believes that the claims against it are without merit and is vigorously defending against them. It is not currently possible to reasonably estimate a probable loss, if any, associated with these cases and, accordingly, no reserves have been recorded in the Company's Consolidated Financial Statements. The Company is reviewing agreements and policies that may provide insurance coverage or indemnity as to these claims and is pursuing coverage under some of these agreements and policies, although there can be no assurance of the results of these efforts. There can be no assurance that these cases, whether as a result of adverse outcomes or as a result of significant defense costs, will not have a material effect on the Company's financial condition, results of operations or cash flows.

In connection with the sale of wild bird food products that were the subject of a voluntary recall in 2008, the Company has been named as a defendant in four putative class actions filed on and after June 27, 2012, which have now been consolidated in the United States District Court for the Southern District of California as In re Morning Song Bird Food Litigation, Lead Case No. 3:12-cv-01592-JAH-RBB. The plaintiffs allege various statutory and common law claims associated with the Company's sale of wild bird food products and a plea agreement entered into in previously pending government proceedings associated with such sales. The plaintiffs allege, among other things, a purported class action on behalf of all persons and entities in the United States who purchased certain bird food products. The plaintiffs assert hundreds of millions of dollars in monetary damages (actual, compensatory, consequential, punitive, and treble); reimbursement, restitution, and disgorgement for benefits unjustly conferred; injunctive and declaratory relief; pre-judgment and post-judgment interest; and costs and attorneys' fees. The Company disputes the plaintiffs' assertions and intends to vigorously defend the consolidated action. Given the early stages of the action, it is not currently possible to reasonably estimate a probable loss, if any, associated with the action and, accordingly, no reserves have been recorded in the Company's Consolidated Financial Statements with respect to the action. There can be no assurance that this action, whether as a result of an adverse outcome or as a result of significant defense costs, will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.
The Company is involved in other lawsuits and claims which arise in the normal course of business. These claims individually and in the aggregate are not expected to result in a material effect on the Company's financial condition, results of operations or cash flows.

NOTE 12. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company is exposed to market risks, such as changes in interest rates, currency exchange rates and commodity prices. To manage a portion of the volatility related to these exposures, the Company enters into various financial transactions. The utilization of these financial transactions is governed by policies covering acceptable counterparty exposure, instrument types and other hedging practices. The Company does not hold or issue derivative financial instruments for speculative trading purposes.

Exchange Rate Risk Management

The Company periodically uses foreign currency forward contracts to manage the exchange rate risk associated with intercompany loans with foreign subsidiaries that are denominated in local currencies. At December 27, 2014, the notional amount of outstanding foreign currency forward contracts was $144.5 million, with a fair value of $1.2 million. At December 28, 2013, the notional amount of outstanding foreign currency forward contracts was $103.7 million, with a fair value of $0.5 million. At September 30, 2014, the notional amount of outstanding foreign currency forward contracts was $149.0 million, with a negative fair value of $0.1 million. The fair value of foreign currency forward contracts is determined based on changes in spot rates. The outstanding contracts will mature during fiscal 2015.

Interest Rate Risk Management

The Company enters into interest rate swap agreements as a means to hedge its variable interest rate risk on debt instruments. The fair values are reflected in the Company's Condensed Consolidated Balance Sheets. Net amounts to be received or paid under the swap agreements are reflected as adjustments to interest expense. Since the interest rate swap agreements have been designated as hedging instruments, unrealized gains or losses resulting from adjusting these swaps to fair value are recorded as elements of accumulated other comprehensive income (loss) ("AOCI") within the Condensed Consolidated Balance Sheets except for any ineffective portion of the change in fair value, which is immediately recorded in interest expense. The fair value of the swap agreements is determined based on the present value of the estimated future net cash flows using implied rates in the applicable yield curve as of the valuation date. On December 20, 2013, in conjunction with entering into the third amended and restated senior secured credit facility, the Company recognized hedge ineffectiveness of $2.0 million which was recorded to interest expense.

Table of Contents

The Company has outstanding interest rate swap agreements with major financial institutions that effectively convert a portion of the Company's variable-rate debt to a fixed rate. The swap agreements had a total U.S. dollar equivalent notional amount of $1,300.0 million at December 27, 2014 and September 30, 2014, and $1,100.0 million at December 28, 2013. Included in the AOCI balance at December 27, 2014 was a loss of $6.1 million related to interest rate swap agreements that is expected to be reclassified to earnings during the next 12 months, consistent with the timing of the underlying hedged transactions.

Commodity Price Risk Management

The Company had outstanding hedging arrangements at December 27, 2014 designed to fix the price of a portion of its projected future urea requirements. The contracts are designated as hedges of the Company's exposure to future cash flow fluctuations associated with the cost of urea. The objective of the hedges is to mitigate the earnings and cash flow volatility attributable to the risk of changing prices. Unrealized gains or losses in the fair value of these contracts are recorded to AOCI within the Condensed Consolidated Balance Sheets. Realized gains or losses remain as a component of AOCI until the related inventory is sold. Upon sale of the underlying inventory, the gain or loss is reclassified to cost of sales. Included in the AOCI balance at December 27, 2014 was a gain of $0.5 million related to urea derivatives that is expected to be reclassified to earnings during the next 12 months, consistent with the timing of the underlying hedged transactions.

The Company also uses derivatives to partially mitigate the effect of fluctuating diesel and gasoline costs on operating results. Any such derivatives that do not qualify for hedge accounting treatment in accordance with GAAP are recorded at fair value, with unrealized gains and losses on open contracts and realized gains or losses on settled contracts recorded as an element of cost of sales. Unrealized gains or losses in the fair value of contracts that do qualify for hedge accounting are recorded in AOCI except for any ineffective portion of the change in fair value, which is immediately recorded in earnings. For the effective portion of the change in fair value, realized gains or losses remain as a component of AOCI until the related fuel is consumed. Upon consumption of the fuel, the gain or loss is reclassified to cost of sales. At December 27, 2014 there were no amounts included within AOCI.

The Company had the following outstanding commodity contracts that were entered into to hedge forecasted purchases:

Commodity	DECEMBER 27, 2014	DECEMBER 28, 2013	SEPTEMBER 30, 2014
Urea	58,500 tons	25,500 tons	58,500 tons
Diesel	6,930,000 gallons	4,830,000 gallons	5,250,000 gallons
Gasoline	462,000 gallons	672,000 gallons	462,000 gallons
Heating Oil	7,728,000 gallons	4,494,000 gallons	4,494,000 gallons

Table of Contents

Fair Values of Derivative Instruments

The fair values of the Company's derivative instruments were as follows:

DERIVATIVES DESIGNATED AS HEDGING INSTRUMENTS	BALANCE SHEET LOCATION	ASSETS / (LIABILITIES) DECEMBER 27, 2014	DECEMBER 28, 2013	SEPTEMBER 30, 2014
		FAIR VALUE (In millions)		
Interest rate swap agreements	Other assets	$2.2	$ 4.8	$ 4.0
	Other current liabilities	(10.2)	(8.4)	(10.3)
	Other liabilities	(5.2)	(12.0)	(5.2)
Commodity hedging instruments	Prepaid and other current assets	0.4	1.1	—
	Other current liabilities	—	—	(0.6)
Total derivatives designated as hedging instruments		$(12.8)	$ (14.5)	$ (12.1)
DERIVATIVES NOT DESIGNATED AS HEDGING INSTRUMENTS	BALANCE SHEET LOCATION			
Foreign currency forward contracts	Prepaid and other current assets	$1.2	$ —	$ —
	Other current liabilities	—	(0.5)	(0.1)
Commodity hedging instruments	Prepaid and other current assets	—	0.4	—
	Other current liabilities	(9.1)	—	(1.3)
Total derivatives not designated as hedging instruments		$(7.9)	$ (0.1)	$ (1.4)
Total derivatives		$(20.7)	$ (14.6	