SCOTTS MIRACLE-GRO CO
Form 10-Q
May 12, 2011

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED APRIL 2, 2011

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	31-1414921
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
14111 SCOTTSLAWN ROAD, MARYSVILLE, OHIO	43041
(Address of principal executive offices)	(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 þ 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 þ 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 þ	Accelerated filero	Non-accelerated filer o (Do not check if a smaller reporting company)	oSmaller 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 þ

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 May 6, 2011
Common Shares, $0.01 stated value, no par value	64,966,209 common shares

THE SCOTTS MIRACLE-GRO COMPANY
INDEX

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 SHARE DATA)

(UNAUDITED)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	APRIL 2, 2011	**APRIL 3, 2010**	**APRIL 2, 2011**	**APRIL 3, 2010**
Net sales	$ 1,129.6	$ 1,050.7	$ 1,359.8	$ 1,303.1
Cost of sales	665.6	635.1	845.9	833.8
Cost of sales product registration and recall matters	1.3	0.6	2.1	1.5
Gross profit	462.7	415.0	511.8	467.8
Operating expenses:				
Selling, general and administrative	216.2	216.7	359.4	343.0
Product registration and recall matters	1.2	1.1	2.1	2.8
Other (income) expense, net	(0.3)	0.5	(0.8)	(5.7)
Income from operations	245.6	196.7	151.1	127.7
Interest expense	13.8	14.1	23.3	23.8
Income from continuing operations before income taxes	231.8	182.6	127.8	103.9
Income tax expense from continuing operations	83.2	68.4	45.9	39.8
Income from continuing operations	148.6	114.2	81.9	64.1
Income (loss) from discontinued operations, net of tax	29.0	4.3	27.8	(3.3)
Net income	$ 177.6	$ 118.5	$ 109.7	$ 60.8
BASIC INCOME PER COMMON SHARE:				
Income from continuing operations	$ 2.26	$ 1.72	$ 1.24	$ 0.97
Income (loss) from discontinued operations	0.44	0.07	0.42	(0.05)
Basic net income per common share	$ 2.70	$ 1.79	$ 1.66	$ 0.92
Weighted-average common shares outstanding during the period	65.8	66.2	66.1	66.0

DILUTED INCOME PER COMMON SHARE:								
Income from continuing operations	$	2.20	$	1.69	$	1.21	$	0.95
Income (loss) from discontinued operations		0.43		0.07		0.41		(0.05)
Diluted net income per common share	$	2.63	$	1.76	$	1.62	$	0.90
Weighted-average common shares outstanding during the period plus dilutive potential common shares		67.6		67.4		67.7		67.2
Dividends declared per common share	$	0.250	$	0.125	$	0.500	$	0.250

See notes to condensed, consolidated financial statements

THE SCOTTS MIRACLE-GRO COMPANY
CONDENSED, CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN MILLIONS)
(UNAUDITED)

	SIX MONTHS ENDED	
	APRIL 2, 2011	**APRIL 3, 2010**
OPERATING ACTIVITIES		
Net income	$ 109.7	$ 60.8
Adjustments to reconcile net income to net cash used in operating activities:		
Share-based compensation expense	10.8	8.2
Depreciation	24.6	24.2
Amortization	5.4	5.6
Gain on sale of long-lived assets	(0.1)	(21.6)
Gain on sale of business	(90.6)	
Changes in assets and liabilities, net of acquired businesses:		
Accounts receivable	(801.7)	(699.4)
Inventories	(202.1)	(136.0)
Prepaid and other assets	(34.4)	(42.1)
Accounts payable	223.4	133.2
Other current liabilities	141.4	43.1
Restructuring reserves	(0.1)	
Other non-current items	5.0	7.3
Other, net	4.7	5.3
Net cash used in operating activities	(604.0)	(611.4)
INVESTING ACTIVITIES		
Proceeds from sale of long-lived assets	0.2	23.6
Proceeds from sale of business, net of transaction costs	249.8	
Investments in property, plant and equipment	(44.5)	(37.9)
Net cash provided by (used in) investing activities	205.5	(14.3)
FINANCING ACTIVITIES		
Borrowings under revolving and bank lines of credit and term loans	993.7	845.5
Repayments under revolving and bank lines of credit and term loans	(651.3)	(440.4)
Proceeds from issuance of Senior Notes, net of discount	200.0	198.5
Financing and issuance fees	(4.1)	(5.5)
Dividends paid	(33.3)	(17.6)
Purchase of treasury shares	(93.7)	
Excess tax benefits from share-based payment arrangements	4.4	3.7
Cash received from exercise of stock options	21.8	12.9
Net cash provided by financing activities	437.5	597.1

Effect of exchange rate changes on cash		1.6		(3.7)
Net increase (decrease) in cash and cash equivalents		40.6		(32.3)
Cash and cash equivalents at beginning of period		88.1		70.6
Cash and cash equivalents at end of period	$	128.7	$	38.3
Supplemental cash flow information				
Interest paid, net of interest capitalized		18.6		20.0
Income taxes paid		4.2		9.0

See notes to condensed, consolidated financial statements

4

Table of Contents

THE SCOTTS MIRACLE-GRO COMPANY
CONDENSED, CONSOLIDATED BALANCE SHEETS
(IN MILLIONS, EXCEPT PER SHARE DATA)

	APRIL 2, 2011	APRIL 3, 2010	SEPTEMBER 30, 2010
	UNAUDITED		(SEE NOTE 1)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 128.7	$ 38.3	$ 88.1
Accounts receivable, less allowances of $7.9, $10.2 and $7.7, respectively	1,142.3	916.2	350.9
Accounts receivable pledged		80.5	
Inventories, net	556.1	531.6	352.9
Assets held for sale		237.9	193.1
Prepaid and other assets	164.5	195.9	133.1
Total current assets	1,991.6	2,000.4	1,118.1
Property, plant and equipment, net of accumulated depreciation of $485.1, $439.7 and $461.1, respectively	396.1	362.7	381.3
Goodwill	305.8	305.8	305.8
Intangible assets, net	344.7	353.5	330.2
Other assets	36.4	29.2	28.6
Total assets	$ 3,074.6	$ 3,051.6	$ 2,164.0
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Current portion of debt	$ 764.6	$ 244.3	$ 195.0
Accounts payable	365.9	301.8	141.7
Liabilities held for sale		45.7	45.3
Other current liabilities	508.5	424.2	354.8
Total current liabilities	1,639.0	1,016.0	736.8
Long-term debt	416.0	1,156.0	436.7
Other liabilities	231.0	205.9	226.0
Total liabilities	2,286.0	2,377.9	1,399.5
Commitments and contingencies (notes 3 and 11)			
Shareholders equity:			
Common shares and capital in excess of $.01 stated value per share, 65.7, 66.9 and 66.8 shares issued and outstanding,	425.7	435.9	434.0

respectively						
Retained earnings		573.3		381.4		499.6
Treasury shares, at cost: 2.6, 1.7 and 1.8 shares, respectively		(139.0)		(90.0)		(92.0)
Accumulated other comprehensive loss		(71.4)		(53.6)		(77.1)
Total shareholders equity		788.6		673.7		764.5
Total liabilities and shareholders equity	$	3,074.6	$	3,051.6	$	2,164.0

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) and its subsidiaries (collectively, together with Scotts Miracle-Gro, the Company) are engaged in the manufacturing, marketing and sale of branded products for consumer 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.

On February 28, 2011, the Company completed the sale of a significant majority of the assets of its Global Professional business (excluding the non-European professional seed business, Global Pro) to Israel Chemicals Ltd. (ICL). Effective in the Company s first quarter of fiscal 2011, the Company classified Global Pro as discontinued operations. See NOTE 2. DISCONTINUED OPERATONS.

Due to the nature of the consumer lawn and garden business, the majority of sales to customers occur in the Company s second and third fiscal quarters. On a combined basis, net sales for the second and third fiscal quarters represent approximately 75% of annual net sales.

ORGANIZATION AND BASIS OF PRESENTATION

The Company s condensed, consolidated financial statements are unaudited; however, in the opinion of management, these financial statements 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. Interim results reflect all normal and recurring adjustments and are not necessarily indicative of results for a full year.

Certain information and 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). The information in 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, 2010, which includes a complete set of disclosures, including the Company s significant accounting policies.

The Company s Condensed, Consolidated Balance Sheet at September 30, 2010 has been derived from the Company s audited Consolidated Balance Sheet at that date, but does not include all of the information and disclosures 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.

RECENT ACCOUNTING PRONOUNCEMENTS

Variable Interest Entities

In June 2009, the Financial Accounting Standards Board (FASB) issued new accounting guidance requiring an enterprise to perform an analysis to determine whether the enterprise s variable interest or interests give it a controlling financial interest in a variable interest entity. The new guidance also requires enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise s involvement in a variable interest entity. The Company adopted the new guidance on October 1, 2010 and the adoption did not impact the Company s financial statements and related disclosures.

Revenue Recognition Multiple-Element Arrangements

In October 2009, the FASB issued new accounting guidance addressing the accounting for multiple-deliverable arrangements to enable entities to account for products or services (deliverables) separately rather than as a combined unit. The provisions establish the accounting and reporting guidance for arrangements under which the entity will perform multiple revenue-generating activities. Specifically, this guidance addresses how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. The Company adopted the new guidance on October 1, 2010 and the adoption did not impact the Company s financial statements and related disclosures.

Table of Contents

NOTE 2. DISCONTINUED OPERATIONS

Global Pro

On February 28, 2011, the Company completed the sale of Global Pro to ICL for $270 million, pursuant to the terms of the definitive share and business sale agreement (the SBSA) between Scotts Miracle-Gro, The Scotts Company LLC (Scotts), a wholly-owned subsidiary of Scotts Miracle-Gro, and ICL. After agreed upon adjustments, the Company received $264.6 million net proceeds at closing. This amount is subject to further post-closing adjustments, primarily relating to working capital, and is expected to be finalized during the Company s third quarter of fiscal 2011. Results from discontinued operations for the first six months of fiscal 2011 include an after-tax gain on the sale of Global Pro of $21.5 million, which includes transaction costs.

The Company s decision to exit the professional ornamental horticulture, turf and specialty agriculture markets and sell Global Pro was another step in its strategy to evolve its business portfolio to better leverage growth opportunities within its core Global Consumer business segment. The Company applied a portion of the net proceeds of the sale toward debt retirement and intends to apply the remaining portion toward capital investments.

In conjunction with the transaction, Scotts and ICL entered into several product supply agreements which are generally up to five years in duration, as well as various trademark and technology licensing agreements with varying durations. The purpose of these agreements is to allow each party to continue leveraging existing production capabilities and intellectual property to meet customer demand for their respective products. Furthermore, certain transitional services are being provided by Scotts to ICL, the majority of which extend for a period of six to 12 months from the date of sale. Scotts estimates that it will supply ICL with approximately $35 million of product, as well as purchase approximately $15 million of materials from ICL, each on an annualized basis.

The Company s continuing cash inflows and outflows related to these agreements are not considered to be significant in relation to the overall cash flows of Global Pro. Furthermore, none of these agreements permit the Company to influence the operating or financial policies of Global Pro under the ownership of ICL. Therefore, Global Pro met the criteria for presentation as discontinued operations. As such, effective in the first quarter of fiscal 2011, the Company classified Global Pro as discontinued operations for all periods presented.

The Global Pro results from discontinued operations include an allocation of interest expense relating to the amount of our senior secured credit facilities that was required to be repaid from the sale proceeds. The amount of interest expense allocated to and included in discontinued operations was $0.7 million and $0.9 million for the three-month periods, and $1.7 million and $2.0 million for the six-month periods ended April 2, 2011 and April 3, 2010, respectively.

Smith & Hawken Ltd.

In July 2009, Scotts Miracle-Gro announced that its wholly-owned subsidiary, Smith & Hawken, Ltd., had adopted a plan to close the Smith & Hawken®+ business. During the Company s first quarter of fiscal 2010, all Smith & Hawken stores were closed and substantially all operational activities of Smith & Hawken were discontinued. As a result, effective in its first quarter of fiscal 2010, the Company classified Smith & Hawken as discontinued operations.

In the first six months of fiscal 2010, the Company incurred charges related to the liquidation of the Smith & Hawken business primarily associated with the termination of retail site lease obligations, third-party agency fees and severance and benefit commitments. These charges were partially offset by a gain of approximately $18 million from the sale of the Smith & Hawken intellectual property on December 30, 2009.

\+ Smith & Hawken® is a registered trademark of Target Brands, Inc. The Company sold the Smith & Hawken brand and certain intellectual property rights related thereto on December 30, 2009, and subsequently changed the name of the subsidiary entity formerly known as Smith & Hawken, Ltd. to Teak 2, Ltd. References in this Quarterly Report on Form 10-Q to Smith & Hawken refer to Scotts Miracle-Gro s subsidiary entity, not the brand itself.

Table of Contents

The following table summarizes the results of Global Pro and Smith & Hawken as discontinued operations (in millions):

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	APRIL 2, 2011	APRIL 3, 2010	APRIL 2, 2011	APRIL 3, 2010
Net sales	$ 41.8	$ 72.4	$ 88.7	$ 137.0
Operating costs	35.9	65.0	78.1	136.5
Impairment, restructuring and other charges				17.1
Gain on sale of Global Pro business	(90.6)		(90.6)	
Global Pro sale related transaction costs	9.6		14.8	
Other (income) expense, net		(0.2)	0.1	(18.5)
Interest expense	0.7	0.9	1.7	2.0
Income (loss) from discontinued operations before income taxes	86.2	6.7	84.6	(0.1)
Income tax expense from discontinued operations	57.2	2.4	56.8	3.2
Income (loss) from discontinued operations	$ 29.0	$ 4.3	$ 27.8	$ (3.3)

The major classes of assets and liabilities of Global Pro were as follows (in millions):

	APRIL 3, 2010	SEPTEMBER 30, 2010
Cash and cash equivalents	$ 1.0	$ 1.0
Accounts receivable, net	96.7	57.5
Inventories, net	57.8	50.7
Prepaid and other assets	2.6	3.4
Property, plant and equipment, net	14.4	13.5
Goodwill	65.4	67.0
Assets held for sale	$ 237.9	$ 193.1
Accounts payable	$ 17.8	$ 11.4
Other current liabilities	17.3	18.7
Other liabilities	10.6	15.2
Liabilities held for sale	$ 45.7	$ 45.3

The major classes of assets and liabilities of Smith & Hawken were as follows (in millions):

	APRIL 2, 2011	APRIL 3, 2010	SEPTEMBER 30, 2010
Assets of discontinued operations in other current assets	$	$ 0.2	$ 1.3

Accounts payable	$		$	3.1	$	
Other current liabilities		0.4		5.2		0.9
Liabilities of discontinued operations	$	0.4	$	8.3	$	0.9

NOTE 3. PRODUCT REGISTRATION AND RECALL MATTERS

In April 2008, the Company became aware that a former associate apparently deliberately circumvented the Company s policies and U.S. Environmental Protection Agency (U.S. EPA) regulations under the Federal Insecticide, Fungicide, and Rodenticide Act of 1947, as amended (FIFRA), by failing to obtain valid registrations for certain products and/or causing certain invalid product registration forms to be submitted to regulators. Since that time, the Company has been cooperating with both the U.S. EPA and the U.S. Department of Justice (the U.S. DOJ) in related civil and criminal investigations into the pesticide product registration issues as well as a state civil investigation into related allegations arising under state pesticide registration laws and regulations.

In late April of 2008, in connection with the U.S. EPA s investigation, the Company conducted a consumer-level recall of certain consumer lawn and garden products and a Scotts LawnService® product. Subsequently, the Company and the U.S. EPA agreed upon a Compliance Review Plan for conducting a comprehensive, independent review of the Company s product registration records. Pursuant to the Compliance Review Plan, an independent third-party firm, Quality Associates Incorporated (QAI), reviewed substantially all of the Company s U.S. pesticide product registrations and associated advertisements, some of which were historical in nature and no longer related to sales of the Company s products. The U.S. EPA investigation and the QAI review process resulted in the temporary suspension of sales and shipments of certain products. In addition, as the QAI review process or the Company s internal review identified potential FIFRA registration issues (some of which appear unrelated to the actions of the former associate), the Company endeavored to stop selling or distributing the affected products until the issues could be resolved. QAI s review of the Company s U.S. pesticide product registrations and associated advertisements is now substantially complete. The results of the QAI review process did not materially affect the Company s fiscal 2010 or year-