Henderson State University

Analysis Report- The Scotts Miracle-Gro Company

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Table of Contents

Market Profile	
Scotts Miracle Gro	
Ticker Symbol	SMG

Company History:

The Scotts Miracle-Gro Company (Scotts Miracle-Gro) is a marketer of lawn fertilizer, grass seed and growing media products within the United States. During the fiscal year ended September 30, 2008 (fiscal 2008), the Company divided its business Global Consumer; Global Professional; Scotts LawnService and Corporate & Other. Its major customers include home centers, mass merchandisers, warehouse clubs, large hardware chains, independent hardware stores, nurseries, garden centers, food and drug stores, commercial nurseries and greenhouses and specialty crop growers.

Product Mix

- In its Global Consumer segment, the Company manufactures and markets products to homeowners who are in search of weed and pest-free lawns, gardens and indoor plants. The Global Consumer segment sells products in categories, such as lawns, gardens, growing media, grass seed, controls, wild bird food and other consumer products.
  - Lawns are a line of granular lawn fertilizer and combination products, which include fertilizer and crabgrass control, weed control or pest control is sold under the Scotts Turf Builder brand name. Gardens are a line of plant foods is marketed under the Miracle-Gro brand name. Growing Media are growing media products for indoor and outdoor uses is marketed under the Miracle-Gro, Scotts, Hyponex, Earthgro and SuperSoil brand names, as well as other labels. The Company offers a line of grass seed products for consumers. Its grass seed products are sold under the Scotts Pure Premium, Classic, Turf Builder and PatchMaster brand names in the consumer market.

- The Global Professional business sells professional products to commercial nurseries, greenhouses and specialty crop growers primarily in North America, Europe, the Middle East, Africa, Latin America, Australia, New Zealand and throughout the Far East. The Company's professional products include a line of controlled-release fertilizers, water-soluble fertilizers, plant protection products, wetting agents, growing media and grass seed that are sold under brand names that include Osmocote, Sierrablen Plus, Peters Professional, Peters Excel, Agroblen, Agrocote, Rout, OH2, Scotts Professional Seed, Scotts Turfseed and Scotts Landmark.

- Through the Scotts LawnService segment, the Company provides residential lawn care, lawn aeration, tree and shrub care, and external pest control services in the United States. These services consist primarily of fertilizer, weed control, pest control and disease control applications. As of September 30, 2008, Scotts LawnService had 81 Company-operated locations serving 46 metropolitan markets and 76 independent franchises primarily operating in secondary markets.

- The Corporate & Other segment includes Smith & Hawken, a brand in the outdoor living and gardening lifestyle category. Smith & Hawken products, which include outdoor furniture, pottery, garden tools, gardening containers and live goods, are sold in the United States through its 57 retail stores, catalog and Internet sales, and other trade and wholesale relationships.
  - The Company competes with Spectrum Brands, Bayer AG, Central Garden & Pet Company, Enforcer Products, Inc., Green Light Company, Agrium, Inc., Haifa Chemicals Ltd., Chisso Asahi Fertilizer Co. Ltd., Syngenta AG, Pursell Industries, Inc., Compo GmbH, Norsk Hydro ASA, Haifa Chemicals Ltd., Kemira Oyj and Lebanon Seaboard Corporation.

Recent Headlines

- **Cramer upgrades SMG, January 28, 2009** Net income increased by 13.9% compared with the same quarter a year ago, outperforming the S&P 500 and the chemicals industry. Revenue increased by 6.6% compared with the industry average of 12% growth. EPS are up 14.3% in the most recent quarter compared with the year-ago quarter. This company has reported somewhat volatile earnings recently, but they feel it is poised for EPS growth in the coming year.
- **SMG Declares Second Quarter Dividend, January 22, 2009** – announced today that its Board of Directors has approved the payment of a cash dividend of $0.125 per share. The dividend is payable February 19, 2009 to shareholders of record on February 5, 2009.
- **ScottsMiracle-Gro Announces Results of Annual Shareholders Meeting**
During the annual meeting, Jim Hagedorn, chairman and chief executive officer, told shareholders he remains confident in the Company's prospects for 2009 and that retailers remain supportive of the lawn and garden category. He also said that ScottsMiracle-Gro will provide private label lawn and garden products to some U.S. retailers in 2009, which will result in incremental sales volume.

Industry Overview

Current Rank: 37
Portfolio Percentage Rank:
Monetary Policy Indicator:
Industry Opinion:

From a sector rotation standpoint, these shares are poised to do well in the future.

Key Issues Affecting the Industry:

Survival has to be a key thought for the entire industry.

Recent Results- 10Q

The Scotts Miracle-Gro Company
Consolidated Statements of Operations
for the fiscal years ended September 30, 2008, 2007 and 2006
(in millions, except per share data)

	2008	2007	2006

Net sales	$ 2,981.80	$ 2,871.80	$ 2,697.10
Cost of sales	1,999.90	1,867.30	1,741.10
Cost of sales — impairment, restructuring and other charges	15.1	—	0.1
Cost of sales — product registration and recall matters	27.2	—	—
Gross profit	939.6	1,004.50	955.9
Operating expenses:			
Selling, general and administrative	717.6	700.9	636.9
Impairment, restructuring and other charges	121.7	38	75.7
Product registration and recall matters	12.7	—	—
Other income, net	(10.4)	(11.5)	(9.2
Income from operations	98	277.1	252.5
Costs related to refinancing	—	18.3	—
Interest expense	82.2	70.7	39.6
Income before income taxes	15.8	188.1	212.9
Income taxes	26.7	74.7	80.2
Net income (loss)	$ (10.9)	$ 113.4	$ 132.7
Basic earnings (loss) per common share	$ (0.17)	$ 1.74	$ 1.97
Diluted earnings (loss) per common share	$ (0.17)	$ 1.69	$ 1.91

Economic Outlook- 10K

The Household Products Industry has regained some lost ground. The group has moved up in ranks for year-ahead price performance (Timeliness went from 55 to 35).This industry is often noted for its defensive qualities. As a whole, it tends to hold up comparatively well during both good times and bad. Although many of the companies herein have been hard hit by sluggish macroeconomic conditions and a more difficult operating environment, we believe that recent efforts ought to help buoy near-term results and should help set the stage for long-term benefits.

The ongoing struggles of the housing and credit markets have spilled over into this sector. Many American consumers have been tightening their purse strings over the past few months. Indeed, the holiday shopping season was relatively weak owing to reined in discretionary spending. Most of the products on these companies' rosters such as, soap, toothpaste, and toilet paper, among others, remain household staples despite economic conditions. But we do not think that people will ''stock up'' on household goods like they used to. What's more, many of the companies implemented incremental price increase across product lines during the third and fourth quarters to help bolster margins. As a result, we may see an increase in comparison shopping and we envision that consumers will further shy away from brand-name goods and choose, instead, private label or generic products, which are often marketed at lower price points. Because American markets tend to be relatively saturated, over the past few years, many of these companies focused on widening their global footprint, instead. Several concentrated on the various emerging markets in Asia and

Latin America, and benefited from the robust growth in those developing economies. But, the American dollar has begun to regain strength, and unfavorable foreign currency fluctuations may well hinder top-line growth. Also, many in this group suffered from a difficult operating environment in 2008. Energy prices and raw material expenses soared for much of the year. And even though we have seen input costs moderate somewhat over the past couple of months, inflationary pressures may still weigh on margins and temper bottom-line growth.

Given the current economic backdrop, we do not look for the household goods companies to make any major changes to their portfolios. Many, however, have used synergies from their most recent acquisitions to jumpstart companywide restructuring programs and cost savings initiatives. Though near-term struggles may continue to plague the group, we think that recent activities will help streamline these businesses and support long-term growth. In addition, some are working on building their product rosters. They are looking to diversify offerings, and introduce more-affordable luxuries, and introduce products with fewer ‘‘bells and whistles’’ and lower price points to cater to thriftier consumers. Also, the companies ought to focus on creating higher-margin goods, which should lift profits, as well.

Most of these consumer conglomerates do not stand out for their year-ahead price performance. Many of the equities herein have been beaten down along with the broader market averages over the past few quarters. But even with the pullback in price, few of these stocks stand out from the crowd for their recovery potential over the 2011-2013 span. Some of these issues have regained some lost ground, and their defensive luster has begun to shine through once again. In addition, several members of the group possess high scores for Financial Strength and for Price Stability. We think that these two factors add investment appeal for more conservative investors or for those that want to diversify more-volatile portfolio mixes. As always, we caution investors from taking too broad a view, and recommend that our readers evaluate each individual company report before making any capital commitments.

Financial Ratios

Valuation Ratios

	Company	Industry	Sector	S&P 500
P/E Ratio (TTM)	--	23.37	2.46	17.93
P/E High - Last 5 Yrs.	NA	3.81	0.8	28.52
P/E Low - Last 5 Yrs.	NA	1.87	0.25	8.08
Beta	0.57	0.78	1.15	0.99
Price to Sales (TTM)	0.75	4.33	1.58	2.29
Price to Book (MRQ)	5.11	6.15	1.84	6.84
Price to Tangible Book (MRQ)	--	8.33	2.8	8.73
Price to Cash Flow (TTM)	37.64	22.79	1.32	12.01
Price to Free Cash Flow (TTM)	19.91	42.43	25.76	158.61
% Owned Institutions	--	--	--	--

Dividends

	Company	Industry	Sector	S&P 500
Dividend Yield	1.46	0.25	0.1	2.55

Dividend Yield - 5 Year Avg.	5.15	0.77	1.36	1.79
Dividend 5 Year Growth Rate	--	10.7	26.73	11.04
Payout Ratio(TTM)	--	10.27	3.62	34.69

Growth Rates

	Company	Industry	Sector	S&P 500
Sales (MRQ) vs Qtr. 1 Yr. Ago	6.94	35.06	7.55	12.88
Sales (TTM) vs TTM 1 Yr. Ago	3.83	25.45	3.07	13.82
Sales - 5 Yr. Growth Rate	8.96	8.29	10.72	15.02
EPS (MRQ) vs Qtr. 1 Yr. Ago	14.96	269.6	62.62	14.51
EPS (TTM) vs TTM 1 Yr. Ago	-111.23	--	--	--
EPS - 5 Yr. Growth Rate	--	30.01	27.52	19.7
Capital Spending - 5 Yr. Growth Rate	1.61	14.75	15.41	13.3

Financial Strength

	Company	Industry	Sector	S&P 500
Quick Ratio (MRQ)	0.93	1.27	1.04	1.04
Current Ratio (MRQ)	1.54	1.88	1.51	1.28
LT Debt to Equity (MRQ)	194.53	28.01	38.88	151.8
Total Debt to Equity (MRQ)	228.88	40.03	64.32	197.45
Interest Coverage (TTM)	3.92	7.22	0.31	31.97

Profitability Ratios

	Company	Industry	Sector	S&P 500
Gross Margin (TTM)	31.51	26.66	2.6	35.5
Gross Margin - 5 Yr. Avg.	34.95	20.34	22.93	36.46
EBITD Margin (TTM)	5.64	--	--	--
EBITD - 5 Yr. Avg	10.77	10.17	15.61	19.58
Operating Margin (TTM)	3.29	16.3	9.76	--
Operating Margin - 5 Yr. Avg.	8.3	6.78	10.25	17.83
Pre-Tax Margin (TTM)	0.53	16.2	9.88	15.75
Pre-Tax Margin - 5 Yr. Avg.	5.63	6.12	10.63	17.59
Net Profit Margin (TTM)	-0.37	12.14	8.88	11.18

Net Profit Margin - 5 Yr. Avg.	3.35	4.33	6.69	12.34
Effective Tax Rate (TTM)	168.99	17.65	2.92	26.44
Effecitve Tax Rate - 5 Yr. Avg.	40.54	21.39	33.23	30.5

Management Effectiveness

	Company	Industry	Sector	S&P 500
Return on Assets (TTM)	-0.49	10.91	2.2	8.05
Return on Assets - 5 Yr. Avg.	4.09	3.33	5.88	7.5
Return on Investment (TTM)	-0.69	14.12	3.1	10.94
Return on Investment - 5 Yr. Avg.	5.39	4.38	8.82	10
Return on Equity (TTM)	-2.38	20.95	2.4	19.09
Return on Equity - 5 Yr. Avg.	10.78	7.22	13.99	20.1

Efficiency

	Company	Industry	Sector	S&P 500
Revenue/Employee (TTM)	467,367	1,809,994	862,526	857,796
Net Income/Employee (TTM)	-1,708	259,981	44,044	98,793
Receivable Turnover (TTM)	7.42	5.69	1.27	10.7
Inventory Turnover (TTM)	4.97	3.9	0.85	9.71
Asset Turnover (TTM)	1.35	0.72	0.09	0.79

DCF Model	
Beta	0.36
Valueline Safety Rating	3
Expected Growth (EPS)	2.00
Projected Growth & Dividend Yield	15.0%
Required Rate Return	5.56%
Projected Future P/E	16.9
Annualized HPR	21.59%
PV of Future Price	$74.45
Recommendation	Undervalued

P/E Sensitivity					
Present Value	Price 2014	P/E 20014	EPS 2014	HPR 2014	Annual Return
48.18	66.00	**11.0**	6.00	2.07	13.32%
56.93	78.00	**13.0**	6.00	2.42	16.40%
65.69	90.00	**15.0**	6.00	2.77	19.13%
74.45	**102.00**	**17.0**	**6.00**	**3.12**	**21.59%**
83.21	114.00	**19.0**	6.00	3.47	23.83%
91.97	126.00	**21.0**	6.00	3.82	25.89%
100.73	138.00	**23.0**	6.00	4.17	27.80%

Earnings Sensitivity					
Present Value	Price 2014	P/E 2014	EPS 2014	HPR 2014	Annual Return
67.01	91.80	17.0	**5.40**	2.82	19.52%
69.49	95.20	17.0	**5.60**	2.92	20.23%
71.97	98.60	17.0	**5.80**	3.02	20.92%
74.45	**102.00**	**17.0**	**6.00**	**3.12**	**21.59%**
76.93	105.40	17.0	**6.20**	3.22	22.25%
79.42	108.80	17.0	**6.40**	3.32	22.88%
81.90	112.20	17.0	**6.60**	3.42	23.51%
67.01	91.80	17.0	**5.40**	2.82	19.52%

Momentum

Momentum Indicator: +1

Analyst's Opinion

Why Buy SMG?

- Strengths include its increase in net income, revenue growth and good cash flow from operations.
- Lower diesel prices will cut shipping costs. Interest expense is also likely to decline since about half of Scotts debt is tied to floating rates.
- Scotts' executives have a lot of motivation to meet management's target. The company's 25 top executives won't receive incentive payments if operating earnings fall below guidance. Moreover, the next 500 managers won't get this payout if share net is under $1.90.
- A dominant market position and favorable demographics should help this well-ranked equity double in price by 2011-2013. The company has over a 50% market share in many lawn and garden categories (reinforced by major advertising expenditures). An aging population favors Scotts since many baby boomers are becoming gardeners.

Why not buy SMG?

- SMG generally has poor debt management, disappointing return on equity and poor profit margins.

Final Discussion:

I would not buy; just hold current stocks we already own.

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