The Scotts Miracle-Gro Company (SMG)

Updated November 7th, 2022 by Nikolaos Sismanis

Key Metrics

Current Price:	$50	**5 Year CAGR Estimate:**	11.8%	**Market Cap:**	$2.79 B
Fair Value Price:	$53	**5 Year Growth Estimate:**	7.0%	**Ex-Dividend Date:**	11/25/22
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.8%	**Dividend Payment Date:**	12/09/22
Dividend Yield:	5.2%	**5 Year Price Target**	$74	**Years Of Dividend Growth:**	12
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Rating:**	Buy

Overview & Current Events

The Scotts Miracle-Gro Company is one of the world's leading marketers of branded consumer lawn and garden as well as hydroponic and indoor growing products. The company offers fertilizers, grass seed products, spreaders, outdoor cleaners, and any lawn-related weed, pest, and disease control products. Scotts Miracle-Gro generates around $3.9 billion in annual revenue and is headquartered in Marysville, Ohio.

On November 2nd, 2022, Scotts Miracle-Gro reported its Q4-2022 and full-year results for the period ending September 30th, 2022, with numbers remaining rather underwhelming. The company recorded sales of $493.6 million during the quarter, a 33% decline compared to Q4-2021, primarily driven by a 49% sales decline in the Hawthorne division and an 18% decline in the U.S. Consumer division. The decline in Hawthorne's sales was due to oversupply issues in the cannabis industry amid record sales last year.

The company is currently being pressured by higher commodity prices that have led to a significant margin decline despite multiple pricing actions. Consequently, adjusted losses-per-share came in at ($2.04) compared to adjusted losses-per-share of ($0.82) in the same period of last year. Accordingly, adjusted earnings-per-share for the year equaled $4.10 compared to $9.23.

To get the business back on the right track and return profitability in both segments to an appropriate level, the company has launched Project Springboard 2.0. The Project targets to reduce costs by $85 million in fiscal 2023 and fiscal 2024.

For fiscal 2023, management expects low single-digit percentage growth in adjusted operating income versus fiscal 2022. Our initial estimates point toward adjusted earnings-per-share of $3.75. Note that excluding this year's forecast, which indicates an earnings potential, all other earnings-per-share figures in the table below depict GAAP metrics.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$2.61	$2.70	$2.62	$5.16	$3.68	$1.13	$8.30	$6.96	$9.20	($7.88)	***$3.75***	***$5.26***
DPS	$1.41	$1.76	$1.82	$1.91	$2.03	$2.14	$2.23	$2.36	$2.52	$2.64	***$2.64***	***$3.06***
Shares	61.7	61.6	61.1	61.1	59.4	56.2	55.5	55.7	55.7	55.5	***55.5***	***55.0***

Scotts Miracle-Gro's EPS has fluctuated over time due to its multiple acquisitions over the years. The jump in profitability post-2018 has been attributable to its Sunlight Supply acquisition, the largest distributor of hydroponic products in the U.S., which unlocked great synergies and substantial cost efficiencies.

The company's future growth lies mostly in the industry's organic growth, potential acquisitions, and the snowballing cannabis industry, which utilizes much of its products. Moving forward, we expect acquisitions to continue (with eight companies purchased since 2013) due to the highly fragmented agricultural industry. Dividend growth has been consistent, numbering 12 years of consecutive annual DPS hikes. Over the past five years, DPS has grown by a compound annual growth rate of 4.3%. Considering the recent operating headwinds, we have lowered our DPS growth estimate from 6% to 3%. We retain our EPS growth estimates to 7%, starting from a low base estimate of $3.75 for this year.

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	22.9	19.2	22.2	25.0	17.1	26.1	70.8	12.0	11.9	21.7	***13.4***	***14.0***
Avg. Yld.	3.1%	2.8%	2.9%	2.8%	2.2%	2.1%	2.7%	2.2%	1.7%	1.3%	***5.2%***	***4.2%***

Over the past decade, Scotts Miracle-Gro's valuation has averaged around 24.9 times its underlying net income. Based on our initial projections for fiscal 2023, the P/E currently stands at 13.4X. Due to Scotts Miracle-Gro's somewhat cyclical business model, the rising-rates environment, and growing competition, we have lowered our previous fair valuation multiple from 15X to 14X adjusted EPS. Nevertheless, we find the stock slightly undervalued at its current levels.

Safety, Quality, Competitive Advantage, & Recession Resiliency

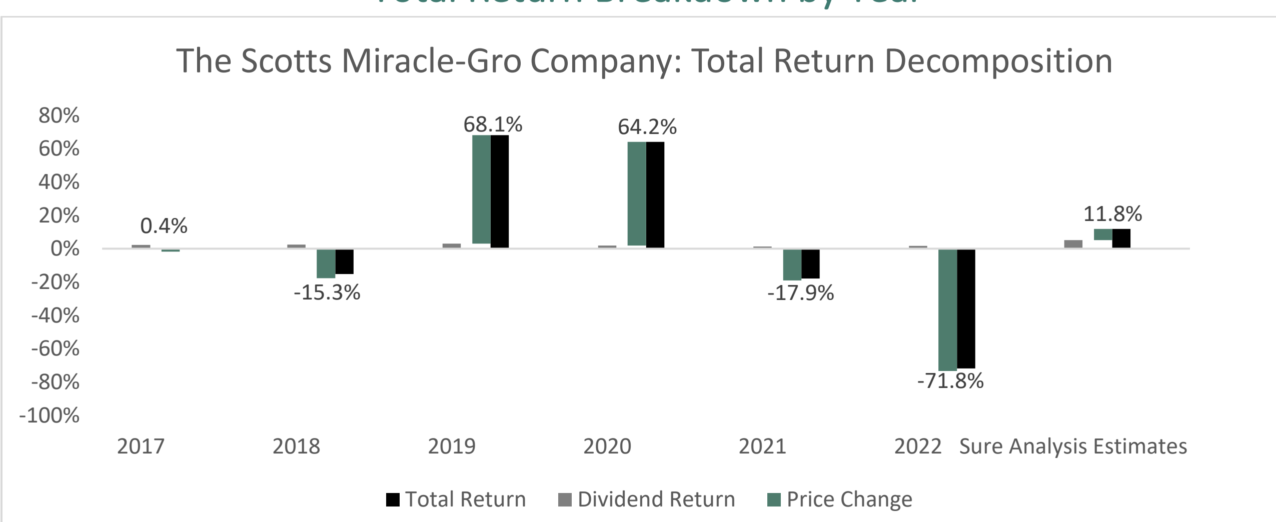
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	54%	65%	69%	37%	55%	189%	27%	34%	27%	-34%	***70%***	***58%***

Scotts Miracle-Gro's dividend should be quite safe. Over the past couple of years, the company's expanded profitability has improved DPS coverage, even encouraging a potential acceleration in its growth. During the last recession, in 2008, the company posted a loss but quickly rebounded. In 2020, despite the adverse effects of COVID-19, sales accelerated driven by the work-from-home economy boosting demand for SMG's products. Hence, the company's resiliency was once again proven. Still, unfavorable trading periods and industry trends can easily harm sales, as is the current situation. It's also important not to overlook the fact that the company's growth is limited to the agricultural industry's growth, which is a very mature one, with few expansion avenues in the consumer market. Moreover, the company faces significant competition and is quite indebted, with a long-term debt/equity ratio of over 1900%.

Final Thoughts & Recommendation

Despite Scotts Miracle-Gro's niche business model, the company has managed to grow over the decades, assisted by management's successful acquisitions. The stock features a decent dividend growth record, while catalysts such as the growing cannabis industry and its accretive acquisitions could keep fueling its growth. While last year's performance was disastrous, we expect gradual improvements. We forecast annualized returns of 11.8% over the medium-term, powered by the company's EPS and DPS growth capacity and slight valuation tailwinds. Shares earn a cautious buy rating. We remind there are multiple risks to SMG's investment case, including ultra-thin margins and high indebtedness.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	2,578	2,371	2,506	2,642	2,663	3,156	4,132	4,925
Gross Profit	890	811	900	973	865	1,020	1,347	1,469
Gross Margin	34.5%	34.2%	35.9%	36.8%	32.5%	32.3%	32.6%	29.8%
SG&A Exp.	512	444	468	489	469	529	687	669
D&A Exp.	64	69	74	80	83	89	95	94
Operating Profit	329	326	393	422	325	418	585	726
Op. Margin	12.8%	13.7%	15.7%	16.0%	12.2%	13.3%	14.2%	14.7%
Net Profit	167	160	315	218	64	461	387	513
Net Margin	6.5%	6.7%	12.6%	8.3%	2.4%	14.6%	9.4%	10.4%
Free Cash Flow	153	(115)	186	294	274	184	495	165
Income Tax	80	76	138	117	(12)	145	124	160

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	2,058	2,527	2,756	2,747	3,055	3,029	3,381	4,800
Cash & Equivalents	89	71	29	121	34	19	17	244
Acc. Receivable	224	158	127	198	226	224	475	483
Inventories	385	396	395	408	481	540	622	1,127
Goodwill & Int.	654	939	1,062	1,191	1,400	1,246	1,223	1,315
Total Liabilities	1,491	1,894	2,022	2,085	2,695	2,306	2,678	3,787
Accounts Payable	193	193	131	153	151	214	391	609
Long-Term Debt	784	1,158	1,216	1,401	2,016	1,652	1,522	2,294
Total Equity	554	621	715	649	355	719	697	1,013
LTD/E Ratio	1.42	1.87	1.70	2.16	5.69	2.30	2.18	2.26

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	8.3%	7.0%	11.9%	7.9%	2.2%	15.1%	12.1%	12.5%
Return on Equity	26.3%	27.2%	47.2%	32.0%	12.7%	85.8%	54.7%	59.9%
ROIC	12.6%	10.2%	16.9%	10.9%	2.9%	19.4%	16.8%	18.5%
Shares Out.	61.6	61.1	61.1	59.4	56.2	55.5	55.7	55.7
Revenue/Share	41.12	38.12	40.42	43.89	46.64	56.06	72.61	88.42
FCF/Share	2.45	(1.85)	3.00	4.88	4.80	3.28	8.70	2.96

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.