

SCOTTS MIRACLE-GRO CO

Form 10-K

November 29, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 2007

OR

☐ 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 1-13292

**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)

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

Securities registered pursuant to Section 12(b) of the Act:

**Title of Each Class**

**Name of Each Exchange On Which Registered**

Common Shares, without par value

New York Stock Exchange

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Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):  
Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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

The aggregate market value of Common Shares (the only common equity of the registrant) held by non-affiliates of the registrant computed by reference to the price at which Common Shares were last sold as of the last business day of the registrant's most recently completed second fiscal quarter (March 30, 2007) was approximately \$1,755,904,160.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: The number of Common Shares of the registrant outstanding as of November 23, 2007 was 64,238,715.

**DOCUMENT INCORPORATED BY REFERENCE:**

**Portions of the definitive Proxy Statement for Registrant's 2008 Annual Meeting of Shareholders to be held January 31, 2008, are incorporated by reference into Part III hereof.**

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## PART I

### **ITEM 1. BUSINESS**

#### **Company Description**

The Scotts Miracle-Gro Company, an Ohio corporation ( Scotts Miracle-Gro and, together with its subsidiaries, the Company ), traces its roots to two businesses launched by entrepreneurs. In 1868, Civil War veteran O.M. Scott launched a seed business in Marysville, Ohio, based on the conviction that farmers shall have clean, weed-free fields. Beginning in 1907, the Company expanded its reach by selling grass seed to consumers and eventually exited the agricultural market. By 1988 both through innovation and acquisition the Company had become a leading marketer of lawn fertilizer, grass seed and growing media products within the United States.

Separately, Horace Hagedorn and his partner Otto Stern launched Stern's Miracle-Gro Products, Inc. in 1951 in New York. Their easy-to-use plant food quickly revolutionized the gardening category. Through aggressive and innovative marketing, Miracle-Gro® eventually became the leading plant food product in the gardening industry. In 1995, The Scotts Company and Stern's Miracle-Gro Products, Inc. merged, marking the start of a significant evolution for the Company.

In the late 1990's, the Company launched a geographic and category expansion. It acquired companies with industry-leading brands in France, Germany and the United Kingdom. In fiscal 1999, the Company acquired the Ortho® brand in the United States and exclusive rights for the marketing and distribution of consumer Roundup®\* brand products within the United States and other specified countries, thereby adding industry-leading controls to its portfolio. The Company has rapidly expanded into the lawn care service industry with the launch of Scotts LawnService® in 1998. Since fiscal 2001, the Company has invested nearly \$125 million in the acquisitions of local and regional lawn care businesses to provide a platform for our rapid expansion throughout the U.S. In October 2004, the Company entered the fast growing outdoor living category with the acquisition of Smith & Hawken, Ltd. The Company entered the North America wild bird food category in fiscal 2006 with the acquisition of Gutwein & Co., Inc. and its Morning Song® brand of wild bird food.

As the Company celebrates more than 100 years of selling products to consumers, we own the leading brands in nearly every category of the lawn and garden industry. A list of some of our North America leading consumer brands is as follows:

Category	Brands
Lawns	Scotts®; Turf Builder®
Gardens	Miracle-Gro®; Osmocote®; LiqueFeed®
Growing Media	Miracle-Gro®; Scotts®; Hyponex®; Earthgro®; SuperSoil®
Grass Seed	Scotts®; Turf Builder®
Controls	Ortho®; Bug-B-Gon®; Weed-B-Gon®; Roundup®
Outdoor Living	Smith & Hawken®
Wild Bird Food	Morning Song®; Scotts®

In addition, we have the following significant brands in Europe: Miracle-Gro® plant fertilizers, Weedol® and Pathclear® herbicides, EverGreen® lawn fertilizers and Levington® growing media in the United Kingdom; KB® and Fertiligène® in France; Celaflor®, Nexa-Lotte® and Substral® in Germany and Austria; and ASEF®, KB® and

Substral® in Belgium, the Netherlands and Luxembourg (the Benelux countries ). Roundup® is also a significant brand in the United Kingdom, France, Germany and other European markets.

### **Business Segments**

For fiscal 2007, we continued to report our business in the following segments:

North America;

\* Roundup® is a registered trademark of Monsanto Technology LLC, a company affiliated with Monsanto Company.

Scotts LawnService®;

International; and

Corporate & Other.

These reportable segments are consistent with the Company's structure and the management of these units. Financial information about these segments for the three years ended September 30, 2007 is presented in Note 20 to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

## North America

In our North America segment, the Company manufactures and markets products that provide easy, reliable and effective assistance to homeowners who seek to nurture beautiful, weed- and pest-free lawns, gardens and indoor plants. These products incorporate many of the best technologies available. In addition, we manufacture and market a broad line of professional products designed to meet the specific needs of commercial nurseries, greenhouses and specialty crop growers in North America. The North America segment sells products in the following categories:

**Lawns:** A complete line of granular lawn fertilizer and combination products, including fertilizer and crabgrass control, weed control or pest control, is sold under the Scotts® Turf Builder® brand name. The Turf Builder® line of products is designed to make it easy for do-it-yourself consumers to select and properly apply the right product in the right quantity for their lawns.

**Gardens:** A complete line of plant foods is marketed under the Miracle-Gro® brand name. In fiscal 2006, we introduced Miracle-Gro® LiquaFeed®, an innovative product that allows consumers to easily feed and water their outdoor plants simultaneously. In addition to our high-quality water-soluble plant foods, we have liquid plant foods, and a continuous-release line of plant foods, Osmocote®, for extended feeding and convenience.

**Growing Media:** A complete line of growing media products for indoor and outdoor uses is marketed under the Miracle-Gro®, Scotts®, Hyponex®, Earthgro®, Nature Scapes®, and SuperSoil® brand names, as well as other labels. These products include potting mix, garden soils, topsoil, manures, sphagnum peat and decorative barks and mulches. The addition of the Miracle-Gro® brand name and fertilizer to higher quality potting mix and garden soils has turned previously low-margin commodity products into value-added category leaders.

**Grass Seed:** We offer a broad line of grass seed products for both the consumer and the professional user. The fiscal 2006 acquisitions of certain brands and assets from Turf-Seed, Inc. and Landmark Seed Company allowed for the integration of these companies' extensive professional grass seed sales and distribution networks with the Company's existing professional presence and industry-leading brands in the consumer grass seed market. Our leading grass seed products are sold under the Scotts® Pure Premium®, Classic®, Turf Builder® and PatchMaster® brand names in the consumer market and the Scotts® Turf-Seed™ and the Scotts® Landmark™ brand names in the professional market.

**Controls:** A broad line of weed control, indoor and outdoor pest control and plant disease control products is marketed under the Ortho® brand name. Ortho® products are available in aerosol, ready-to-use liquids, concentrated, granular and dust forms. Ortho® control products include Weed-B-Gon MAX®, Bug-B-Gon MAX®, Home Defense MAX®, Ortho MAX®, Brush-B-Gon®, RosePride®, Ortho-Klor® and Orthene® Fire Ant Killer.

In fiscal 1999, the Company entered into a long-term marketing agreement with Monsanto Company (Monsanto) and became Monsanto's exclusive agent for the marketing and distribution of consumer Roundup® non-selective herbicide

products in the consumer lawn and garden market within the United States and other specified countries, including Australia, Austria, Belgium, Canada, France, Germany, Holland and the United Kingdom. (See the Roundup® Marketing Agreement discussion later in this Item 1 for a more detailed explanation of the Company's agreement with Monsanto.)

**Wild Bird Food:** In November 2005, the Company acquired Gutwein & Co., Inc. ( Gutwein ). Through its Morning Song® brand, Gutwein is a leader in the growing North America wild bird food category, generating approximately \$80.0 million in annual revenues. Morning Song® products are sold at leading mass retailers, grocery, pet and general merchandise stores. The Company launched a Scotts® branded line of wild bird food in fiscal 2007, with higher quality content and innovative packaging.

**Other Consumer Products:** The Company also manufactures and markets several lines of high-quality lawn spreaders under the Scotts® brand name - Deluxe EdgeGuard® spreaders, SpeedyGreen® rotary spreaders, AccuGreen® drop spreaders and Handy Green®II handheld spreaders. We sell a line of hose-end applicators for water-soluble plant foods such as Miracle-Gro® products, and lines of applicators under the Ortho®, Dial N Spray®, and Pull N Spray® trademarks for the diluted application of control products sold in the concentrated form.

The North America segment also includes our North American Professional, Canadian consumer and Australia consumer and professional business operations. The North American Professional business sells professional products to commercial nurseries, greenhouses and specialty crop growers in North America, the Caribbean and throughout Latin America, the Far East, New Zealand and Japan. Our professional products include a broad line of sophisticated controlled-release fertilizers, water-soluble fertilizers, pesticide products and wetting agents that are sold under brand names that include Banrot®, Miracle-Gro®, Osmocote®, Peters®, Poly-S®, Rout®, ScottKote®, Sierrablen®, Shamrock® and Sierra®. In Canada, we believe we are the leading marketer of branded consumer lawn and garden products. We sell a full range of lawn and garden fertilizer, control products, grass seed, spreaders, and value-added growing media products under the Scotts®, Turf Builder®, Miracle-Gro®, Killex®, and Roundup® brands.

### **Scotts LawnService®**

The Scotts LawnService® segment 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, 2007, Scotts LawnService® had 80 company-operated locations serving 46 metropolitan markets and 78 independent franchises primarily operating in secondary markets.

### **International**

The International segment sells consumer lawn and garden products in more than 25 countries outside of North America. We also sell a broad line of professional products throughout Europe to commercial nurseries, greenhouses and specialty retailers.

International products and brand names vary from country to country depending upon the brand name strength and the nature of our strategic relationships in a given country. For example, in the United Kingdom, we sell Miracle-Gro® plant fertilizers and growing media, Weedol® and Pathclear® herbicides, EverGreen® lawn fertilizers and Levington® growing media. Our other International brands include KB® and Fertiligène® in France; Celaflor®, Nexa-Lotte® and Substral® in Germany and Austria; and ASEF®, KB® and Substral® in the Benelux countries. As noted earlier, Roundup® is also a significant brand in Europe.

For information concerning risks attendant to our foreign operations, please see ITEM 1A. RISK FACTORS Cautionary Statement on Forward-Looking Statements Foreign Operations and Currency Exposures.

### **Corporate and Other**

The Corporate and Other segment includes Smith & Hawken®, a leading brand in the fast growing outdoor living and gardening lifestyle category. Smith & Hawken® products, which include high-end outdoor furniture, pottery, garden tools, gardening containers and live goods, are sold in the United States through its 61 retail stores, catalog and Internet sales, and other trade and wholesale relationships.

### **Competitive Marketplace**



Our major customers include home improvement 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. Each of our segments participates in markets that are highly competitive and many of our competitors sell their products at prices lower than ours. The Company attributes its market leadership and continued success in the lawn and garden category to our industry-leading brands, innovative products, award-winning advertising, supply chain excellence, highly effective field sales and merchandising organization, and the strength of our relationships with major retailers in our product categories.

In the North American consumer do-it-yourself lawn and garden markets and pest control markets, we compete primarily against control label products as well as branded products. Control label products are those sold under a retailer-owned label or a supplier-owned label, which are sold exclusively at a specific retail chain. The control label products that we compete with include Vigoro® products sold at Home Depot, and Sta-Green® products sold at Lowe's. Our competitors in branded lawn and garden products and the consumer pest control markets include Spectrum Brands, Bayer AG, Central Garden & Pet Company, Garden Tech, Enforcer Products, Inc., Green Light Company and Lebanon Chemical Corp.

With respect to growing media products, in addition to nationally distributed, branded competitive products, we face competition from regional competitors who compete primarily on the basis of price for commodity growing media business.

In the North American professional horticulture markets, we face a broad range of competition from numerous companies such as Agrium, Haifa Chemicals Ltd., Chisso Asahi Fertilizer Co. Ltd., Syngenta, and Bayer AG. Some of these competitors have significant financial resources and research departments.

We have the second largest market share position in the U.S. do-it-for-me lawn care service market. We compete against TruGreen-ChemLawn®, a division of ServiceMaster, which has the leading market share in the U.S. lawn care service market and has a substantially larger share of this market than Scotts LawnService®, as well as numerous regional and local lawn care services operations.

Internationally, we face strong competition in the consumer do-it-yourself lawn and garden market, particularly in Europe. Our competitors in the European Union include Bayer AG, Kali & Salz (which owns the Compo, Algoflash brands), Westland and a variety of local companies.

The International professional horticulture markets in which we compete are also very competitive, particularly the markets for controlled-release and water-soluble fertilizer products. We have numerous U.S. and European competitors in these international markets, including Pursell Industries, Inc., Compo GmbH, a subsidiary of Kali & Salz, Norsk Hydro ASA, Haifa Chemicals Ltd. and Kemira Oyj.

### **Significant Customers**

Approximately 70% of our worldwide net sales in fiscal 2007 were made by our North America segment. Within the North America segment, approximately 29% of our net sales in fiscal 2007 were made to Home Depot, 16% to Lowe's and 15% to Wal-Mart. We face strong competition for the business of these significant customers. The loss of any of these customers or a substantial decrease in the volume or profitability of our business with any of these customers could have a material adverse effect on our earnings and profits.

### **Competitive Strengths**

#### **Strong Brands**

By far, the Company considers its industry-leading brands to be its single largest competitive advantage, though hardly its only advantage. The Company believes it has the leading market share in every major U.S. category in which its North American business competes. The Company also owns many of the leading brands in the European marketplace.

The Company has helped to build the awareness of its brands through a continuous increase in its investment in advertising. As a result, consumer awareness of the Company's key brands especially in the United States - rivals that

of nearly any other consumer products company. The strength of the Scotts® brand, in particular, has been a critical aspect of the success of Scotts LawnService®. The Company believes it has successfully grown its service business because of the high level of consumer confidence associated with the Scotts® brand.

### **Trademarks, Patents and Licenses**

The Company considers its brands, patents and licenses all to be key competitive advantages. We pursue a vigorous brand protection strategy consisting of registration and maintenance of key trademarks and proactive monitoring and enforcement activities to protect against infringement. The Scotts®, Miracle-Gro®, Ortho®, Smith & Hawken®, Osmocote®, Hyponex® and Earthgro® brand names and logos, as well as a number of product trademarks, including Turf Builder®, Organic Choice®, Home Defense

and Weed-B-Gon<sup>®</sup>, are federally and/or internationally registered and are considered material to our business.

As of September 30, 2007, we held 93 issued patents in the United States covering fertilizer, chemical and growing media compositions and processes; grass varieties; and mechanical dispensing devices such as applicators, spreaders and sprayers. Many of these have similar patents which have also been issued or are pending internationally, bringing our total worldwide patent portfolio to 461 United States and International patents and applications. The issued patents provide protection generally extending to 20 years from the date of filing, subject to the payment of applicable governmental maintenance and annuity fees. Accordingly, many of our patents will extend well into the next decade.

In addition, we continue to file new patent applications each year covering new, commercially significant developments conceived by our R&D associates. Currently, we have 89 pending patent applications worldwide, including 14 pending U.S. applications, some of which have been allowed for issuance of patents. We also hold exclusive and non-exclusive patent licenses and supply arrangements with various active ingredient and raw material suppliers, permitting the use and sale of additional patented fertilizers, pesticides and mechanical devices.

During fiscal 2007, we were granted 2 U.S. and 22 foreign national patents. Representative of the patent coverage provided by these new patents are coated fertilizers including granular water soluble fertilizers and fertilizers that are specifically formulated to provide delayed-release or triggered-start action when applied to turf; improved spraying devices and the design of such spraying devices; new broadcast spreader devices and coconut coir pith containing growth media products and processes. We continue to extend patent coverage of our core technologies to provide protection of our developments nationally and in additional countries within our Canadian, European, Asia/Pacific and South American markets.

Four U.S. patents expired in fiscal 2007. These expired patents covered fertilizer gel compositions; Kentucky Bluegrass plant varieties; and spreader devices. The loss of these patents is not expected to materially affect our business.

### **Supply Chain and Sales Force**

Because the Company sells a substantial majority of its products to a small number of retail accounts, it is critical to maintain strong relationships with these partners. We believe our supply chain and sales force have become major competitive advantages that have allowed us to build relationships with our key retail partners that are unrivaled in the industry.

Major investments in technology have allowed the Company's supply chain to be a more efficient supplier to its key retail accounts. The Company considers its order fill rate which measures the accuracy of shipments to be an important measure of customer service. In fiscal 2007, the Company achieved a customer service rate of 98.9 percent in its core North American business, its highest ever. Additionally, the supply chain has helped the Company to improve its inventory turns over the past several years, as well as those of its retail partners.

The Company's nationwide sales force is another major competitive advantage. By increasing the size of the sales force over several years, the Company has taken a more proactive role in helping our retail partners merchandise the lawn and garden department and maximize the productivity of this space. In addition to working closely with our retail partners, our sales force works directly with consumers. By serving as in-store counselors on weekends, our associates help consumers answer their lawn and garden questions, which, we believe, drives higher sales of our products.

### **Innovation**

The Company views its commitment to innovation as a competitive advantage. Consequently, we continually invest in research and development and consumer research to improve existing products and develop new products, manufacturing processes, and packaging and delivery systems. Spending on research and development was \$38.8 million, \$35.1 million and \$38.0 million in fiscal 2007, fiscal 2006, and fiscal 2005, including registrations of \$9.3 million, \$8.2 million and \$7.5 million, respectively. The Company's long-standing commitment to innovation is evidenced by a portfolio of patents worldwide that supports many of our fertilizers, grass seeds and application devices. In addition to the benefits of

our own research and development, we benefit from the research and development activities of our suppliers.

Our research and development worldwide headquarters is located at the Dwight G. Scott Research Center in Marysville, Ohio. We also have research and development facilities in the United Kingdom, France, the Netherlands and Sydney, Australia, as well as several research field stations located throughout the United States.

The Company's biotechnology program is evidence of its commitment to responsible research in search of more effective and easier-to-use products that are preferred by consumers and are better for the environment. By employing technology already proven in agriculture, the Company is working to develop turf varieties that could one day require less maintenance, less water and fewer chemical inputs to resist insects, weeds and disease.

Before a product enhanced with biotechnology may be sold in the United States, it must be deregulated by appropriate governmental agencies. Deregulation involves compliance with the rules and regulations of, and cooperation with, the United States Department of Agriculture (the USDA), Animal and Plant Health Inspection Service, the United States Environmental Protection Agency (the U.S. EPA) and/or the Food and Drug Administration (the FDA). As part of the deregulation process for any product enhanced with biotechnology, we are required to present evidence to the USDA in the form of scientifically rigorous studies showing that the product poses no additional toxicological or ecological risk than products of the same species that have not been enhanced with biotechnology. We are also required to satisfy other agencies, such as the U.S. EPA and the FDA, as to their appropriate areas of regulatory authority. This process typically takes years to complete and also includes at least two opportunities for public comment. Therefore, any enhanced product for which we seek commercialization through submission of a petition for deregulation will be subjected to rigorous and thorough governmental regulatory review.

We submitted a petition for deregulation of a non-residential turfgrass product enhanced with biotechnology to the USDA on April 14, 2003. This turfgrass has been shown, through our research trials, to provide simple, more flexible and better weed control for golf courses in a manner we believe is more environmentally friendly. The USDA has a variety of options in adjudicating a petition to deregulate a biotechnology-derived plant product. The USDA has decided to employ the formal Environmental Impact Statement (EIS) process to judge the acceptability of our petition for deregulation. We welcome this process as the most thorough evaluative step available to the USDA. However, there can be no assurance our petition for deregulation of this product will be approved, or if approved and commercially introduced, this product will generate any revenues or contribute to our earnings.

### **Roundup® Marketing Agreement**

The Company is Monsanto's exclusive agent for the marketing and distribution of consumer Roundup® 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, Holland and the United Kingdom. Under the Marketing Agreement, we and Monsanto are jointly responsible for developing global consumer and trade marketing programs for consumer Roundup®. We have assumed responsibility for sales support, merchandising, distribution and logistics for consumer Roundup®. Monsanto continues to own the consumer Roundup® business and provides significant oversight of its brand. In addition, Monsanto continues to own and operate the agricultural Roundup® business.

We are compensated under the Marketing Agreement based on the success of the consumer Roundup® business in the markets covered by the agreement. We receive a graduated commission to the extent that the earnings before interest and taxes of the consumer Roundup® business in the included markets exceed specified thresholds. Regardless of these earnings, we are required to make an annual contribution payment against the overall expenses of the consumer Roundup® business. The minimum annual contribution payment is \$20 million until 2018 or the earlier termination of the agreement.

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 net sales in the Company's Consolidated Statements of Operations. For fiscal 2007 and fiscal 2006, the net amount earned under the Marketing Agreement was income of \$41.9 million and \$39.9 million, respectively. For

fiscal 2005, an expense of \$5.3 million (including a \$45.7 million charge for contribution payments previously deferred) was recognized. For further details, see Note 4 to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

The Marketing Agreement has no definite term, except as it relates to the European Union countries where the term extends through September 30, 2008. The parties may agree to renew the agreement with respect to the European Union countries for two successive terms ending on September 30, 2015 and 2018, with a separate determination being made by the parties at least six months prior to the expiration of each such term as to whether to commence a subsequent renewal term. However, if Monsanto does not agree to either of the remaining renewal terms with respect to the European Union countries, the commission structure will be renegotiated within the terms of the Marketing Agreement.

Monsanto has the right to terminate the Marketing Agreement upon certain specified events of default by us, including an uncured material breach, material fraud, material misconduct or egregious injury to the Roundup® brand. Monsanto also has the right to terminate the Marketing Agreement upon a change of control of Monsanto or the sale of the consumer Roundup® business. In addition, Monsanto may terminate the Marketing Agreement within specified regions, including North America, for specified declines in the consumer Roundup® business.

The Company has rights similar to Monsanto's to terminate the Marketing Agreement upon an uncured material breach, material fraud or material willful misconduct by Monsanto. In addition, we may terminate the Marketing Agreement upon Monsanto's sale of the consumer Roundup® business or in certain other circumstances, in which case we would not be able to collect the termination fee described below.

If Monsanto terminates the Marketing Agreement upon a change of control of Monsanto or the sale of the consumer Roundup® business prior to September 30, 2008, we will be entitled to a termination fee in excess of \$100 million. If we terminate the Marketing Agreement upon an uncured material breach, material fraud or material willful misconduct by Monsanto, we will be entitled to receive a termination fee in excess of \$100 million if the termination occurs prior to September 30, 2008. The termination fee declines over time from in excess of \$100 million to a minimum of \$16 million for terminations between September 30, 2008 and September 30, 2018.

Monsanto has agreed to provide us with notice of any proposed sale of the consumer Roundup® business, allow us to participate in the sale process and negotiate in good faith with us with respect to a sale. In the event we acquire the consumer Roundup® business in such a sale, we would receive credit against the purchase price in the amount of the termination fee that would otherwise have been paid to us upon termination by Monsanto of the Marketing Agreement upon the sale. If Monsanto decides to sell the consumer Roundup® business to another party, we must let Monsanto know whether we intend to terminate the Marketing Agreement and forfeit any right to a termination fee or whether we will agree to continue to perform under the Marketing Agreement on behalf of the purchaser, unless and until the purchaser terminates our services and pays any applicable termination fee.

### **Strategic Initiatives**

The Company has developed a strategic plan that focuses its efforts and capitalizes on its strengths to further own the relationship with its consumers and distance itself from the competition. The execution of this strategy will sustain future growth and further secure the Company's franchise. The critical elements of this strategy are as follows.

### **Leveraging our core strengths and competitive advantages in the United States**

As stated previously, the Company has succeeded, in large degree, due to our ability to leverage our competitive advantages, including our world-class supply chain, industry-leading brands and our commitment to innovation. The



opportunity to further build upon these strengths is a major focus of the Company and will be key to driving continued growth and financial improvement.

Specifically, the Company is investing behind a key initiative to further improve upon its technologies and processes with the goals of enabling increased supply chain synergies and creating global shared services that result in lower selling, general, and administrative costs. In addition to this effort, the Company is currently exploring other supply chain initiatives designed to lower our cost structure without compromising our commitment to quality. For example, the Company will launch a pilot

program in fiscal 2008 to explore the economic viability of regional manufacturing and distribution of lawn fertilizer.

In addition, the Company intends to increase its investment in its sales force, an area that is also considered to be a key competitive advantage. The Company's interaction with its major retail partners is a key reason for its success. In fact, several of the Company's largest retail partners have awarded us with "vendor of the year" or similar honors over the past several years. In addition to working closely with retailers, the sales force also provides the Company an opportunity to interact with consumers on a 1-to-1 basis in stores. Our in-store counseling program, which is utilized during the peak of the lawn and garden season, provides the Company with a critical advantage by helping consumers. Of course, the Company also uses other means to build upon its relationships with consumers. To that end, in fiscal 2008, the Company intends to launch a state-of-the-art website that will improve our ability to communicate with consumers while also creating an online experience that allows them to speak with each other in public chat rooms, message boards and blogs. In addition to the website, the Company plans to increase its investment in promotions, cross-branding and other key marketing initiatives in fiscal 2008.

Research and development initiatives also will be increasingly focused on helping to create a more positive experience for consumers who use our products. Over the years, we have a proven track record of growing our business by providing consumers with value-added products that make success in the lawn or garden easier to attain. Looking ahead, we are focused on developing even more products that are easier to buy, easier to use and easier to store. Our commitment to environmental stewardship also will become increasingly evident in products currently under development or being considered.

### **Strengthening our International Business**

We continue to believe in the long-term growth potential of our International business. In order to maximize shareholder value in this business, we have sharpened our focus by: (i) reducing costs in the business to improve profitability and to allow for marketing investments; (ii) aligning the organization by category rather than by geography to better leverage our knowledge of the marketplace and the consumer; and (iii) better leveraging the Company's innovation competencies. We plan to achieve these goals through a variety of initiatives, including reducing the complexity of the business and the product portfolio, improving supply chain efficiency and effectiveness, and aggressively pursuing new business opportunities. As part of a broader corporate initiative, we will invest to improve our technology platform in the International business, which we believe will continue to reduce costs while allowing us to continue improving our customer service levels.

### **Expanding Scotts LawnService®**

The number of lawn owners who want to maintain their lawns and gardens but do not want to do it themselves represents a significant portion of the total market. We recognize that our portfolio of well-known brands provides us with a unique ability to extend our business into lawn and garden services and the strength of our brands provides us with a competitive advantage in acquiring new customers. We have spent the past several years developing our Scotts LawnService® business model. The business has grown significantly from revenues of \$41.2 million in fiscal 2001 to revenues of \$230.5 million in fiscal 2007. This growth has come from geographic expansion, acquisitions and organic growth fueled by our direct marketing programs. We invested \$22.5 million in lawn service acquisitions in fiscal 2007. We anticipate continuing to make selective acquisitions in fiscal 2008 and beyond. Ongoing investments will continue to be made in the Scotts LawnService® business infrastructure in order to continually improve our customer service throughout the organization and leverage scale economies as we continue to grow.

### **Seasonality and Backlog**

Our business is highly seasonal with 70% to 75% of our annual net sales occurring in our combined second and third fiscal quarters.

Consistent with prior years, we anticipate significant orders for the upcoming spring season will start to be received late in the winter and continue through the spring season. Historically, substantially all orders are received and shipped within the same fiscal year with minimal carryover of open orders at the end of the fiscal year.

## **Raw Materials**

We purchase raw materials for our products from various sources that we presently consider to be adequate, and no one source is considered essential to any of our segments or to our business as a whole. We are subject to market risk from fluctuating market prices of certain raw materials including urea, resins, grass seed, and wild bird food components. Our objectives surrounding the procurement of these materials are to ensure continuous supply and to minimize costs. We seek to achieve these objectives through negotiation of contracts with favorable terms directly with vendors. When appropriate, we will procure a certain percentage of our needs in advance of the season to secure pre-determined prices. Occasionally, we hedge certain commodities to improve predictability and control costs.

## **Manufacturing and Distribution**

We manufacture products for our North American consumer business at our facilities in Marysville, Ohio, Ft. Madison, Iowa and Temecula, California, as well as at a number of third party contract packers in the United States and Canada. In addition, the Company manufactures growing media products in 27 regional facilities located throughout North America. The primary distribution centers for our North American consumer business are managed by the Company and strategically placed across the United States.

We also manufacture horticultural products for our North America and International professional businesses at a leased fertilizer manufacturing facility in Charleston, South Carolina and a Company-owned site in Heerlen, the Netherlands. The remaining products for our professional businesses are produced at other Company-owned facilities and subcontractors in the United States and Europe. The majority of shipments to customers are made via common carriers or through distributors in the United States and a network of public warehouses and distributors in Europe. We are subject to market risk from fluctuating market prices of diesel, which our common carriers pass on to the Company in the form of fuel surcharges. When appropriate, the Company will hedge a portion of these indirect fuel costs to improve predictability and control costs.

We manufacture the non-growing media products for our International business at our facilities in Howden, the United Kingdom and Bourth, France. We also utilize a number of third party contract packers. The primary distribution centers for our International businesses are located in the United Kingdom, France and Germany and are managed by a logistics provider.

The growing media products for our International segment are produced at our facilities in Hatfield, the United Kingdom and Hautmont, France and at a number of third party contract packers. Growing media products are generally shipped direct without passing through a distribution center.

## **Employees**

As of September 30, 2007, we employed 5,081 full-time employees in the United States and an additional 1,039 full-time employees located outside the United States. During peak sales and production periods, we utilize seasonal and temporary labor.

None of our U.S. employees are members of a union. Approximately 45 of our full-time U.K. employees are members of the Transport and General Workers Union and have full collective bargaining rights. An undisclosed number of our full-time employees at our office in Ecully, France are members of the Confederation Francaise Democratique du Travail and Confederation Generale du Travail, participation in which is confidential under French law. In addition, a number of union and non-union full-time employees are members of works councils at three sites in Bourth, Hautmont and Ecully, France, and a number of non-union employees are members of works councils in Ingelheim, Germany. In the Waardenburg office and in the Heerlen Plant in the Netherlands, approximately 120 employees are

members of a workers union, but we are not responsible for collective bargaining negotiations with this union. In the Netherlands, we are governed by the Works Councils Act with respect to the union. Works councils represent employees on labor and employment matters and manage social benefits.

We believe we have good relationships with our employees in the United States, and both unionized and non-unionized International employees.

## **Environmental and Regulatory Considerations**

Local, state, federal and foreign laws and regulations relating to environmental matters affect us in several ways. In the United States, all products containing pesticides must be registered with the U.S. EPA (and similar state agencies) before they can be sold. The inability to obtain or the cancellation of any such registration could have an adverse effect on our business, the severity of which would depend on the products involved, whether another product could be substituted and whether our competitors were similarly affected. We attempt to anticipate regulatory developments and maintain registrations of, and access to, substitute active ingredients, but there can be no assurance that we will continue to be able to avoid or minimize these risks. Fertilizer and growing media products are also subject to state and foreign labeling regulations. Our manufacturing operations are subject to waste, water and air quality permitting and other regulatory requirements of federal and state agencies.

The Food Quality Protection Act, enacted by the U.S. Congress in August 1996, establishes a standard for food-use pesticides, which standard is the reasonable certainty that no harm will result from the cumulative effects of pesticide exposures. Under this Act, the U.S. EPA is evaluating the cumulative risks from dietary and non-dietary exposures to pesticides. The pesticides in our products, certain of which may be used on crops processed into various food products, are typically manufactured by independent third parties and continue to be evaluated by the U.S. EPA as part of this exposure risk assessment. The U.S. EPA or the third party registrant may decide that a pesticide we use in our products will be limited or made unavailable to us. We cannot predict the outcome or the severity of the effect of these continuing evaluations.

In addition, the use of certain pesticide and fertilizer products is regulated by various local, state, federal and foreign environmental and public health agencies. These regulations may include requirements that only certified or professional users apply the product or that certain products be used only on certain types of locations (such as not for use on sod farms or golf courses ), may require users to post notices on properties to which products have been or will be applied, may require notification to individuals in the vicinity that products will be applied in the future or may ban the use of certain ingredients. We believe we are operating in substantial compliance with, or taking action aimed at ensuring compliance with, these laws and regulations.

State and federal authorities generally require growing media facilities to obtain permits (sometimes on an annual basis) in order to harvest peat and to discharge storm water run-off or water pumped from peat deposits. The state permits typically specify the condition in which the property must be left after the peat is fully harvested, with the residual use typically being natural wetland habitats combined with open water areas. We are generally required by these permits to limit our harvesting and to restore the property consistent with the intended residual use. In some locations, these facilities have been required to create water retention ponds to control the sediment content of discharged water.

## **Regulatory Actions**

In 1997, the Ohio Environmental Protection Agency (the Ohio EPA ) initiated an enforcement action against us with respect to alleged surface water violations and inadequate wastewater treatment capabilities at our Marysville, Ohio facility and seeking corrective action under the federal Resource Conservation and Recovery Act. The action related to discharges from on-site waste water treatment and several discontinued on-site disposal areas, which date back to the early operations of the Marysville facility that we had already been assessing and, in some cases, remediating, on a voluntary basis. We are remediating the Marysville site under the terms of a judicial consent order under the oversight of the Ohio EPA.

We completed negotiations with the Philadelphia District of the U.S. Army Corps of Engineers regarding the terms of site remediation and the resolution of the Corps' civil penalty demand in connection with our prior peat harvesting

operations at our Lafayette, New Jersey facility. A final consent decree was entered into on October 18, 2004 that required us to perform five years of wetland monitoring, and the completion of additional actions if after five years, the monitoring indicates the wetlands have not developed satisfactorily.

At September 30, 2007, \$4.6 million was accrued for the environmental and regulatory matters described herein, the majority of which is for site remediation. Most of the costs accrued as of September 30, 2007 are expected to be paid in fiscal 2008; however, payments could be made for a period thereafter.

We believe the amounts accrued as of September 30, 2007 are adequate to cover our known environmental exposures based on current facts and estimates of likely outcome. However, the adequacy of these accruals is based on several significant assumptions, including the following:

that we have identified all of the significant sites that must be remediated;

that there are no significant conditions of potential contamination that are unknown to us; and

that with respect to the agreed judicial consent order in Ohio, the potentially contaminated soil can be remediated in place rather than having to be removed and only specific stream segments will require remediation as opposed to the entire stream.

If there is a significant change in the facts and circumstances surrounding these assumptions, it could have a material impact on the ultimate outcome of these matters and our results of operations, financial position and cash flows.

During fiscal 2007, fiscal 2006 and fiscal 2005, we expensed approximately \$1.5 million, \$2.4 million, and \$3.7 million for environmental matters. There were no material capital expenditures during the last three fiscal years related to environmental or regulatory matters.

### **General Information**

The Company maintains a website at <http://investor.scotts.com> (this uniform resource locator, or URL, is an inactive textual reference only and is not intended to incorporate our website into this Form 10-K). We file reports with the Securities and Exchange Commission (the SEC) and make available, free of charge, on or through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as well as our proxy and information statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

On March 18, 2005, we consummated the restructuring of our corporate structure into a holding company structure by merging The Scotts Company (Scotts) which had been the public company, into a newly-created, wholly-owned, second-tier Ohio limited liability company, The Scotts Company LLC (Scotts LLC), pursuant to the Agreement and Plan of Merger, dated as of December 13, 2004 (the Merger Agreement), among Scotts, Scotts LLC and Scotts Miracle-Gro. As a result of this restructuring merger, each of Scotts' common shares issued and outstanding immediately prior to the consummation of the restructuring merger was automatically converted into one fully paid and nonassessable common share of Scotts Miracle-Gro. Scotts Miracle-Gro became the public company successor to Scotts and Scotts LLC a direct, wholly-owned subsidiary of Scotts Miracle-Gro. The restructuring merger did not affect the new parent holding company's management, corporate governance or capital stock structure. In addition, the consolidated assets and liabilities of Scotts Miracle-Gro and its subsidiaries (including Scotts LLC) immediately after the restructuring merger were the same as the consolidated assets and liabilities of Scotts and its subsidiaries immediately before the restructuring merger.

### **Financial Information About Geographic Areas**

For certain information concerning our International revenues and long-lived assets, see ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS and Note 20 to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

### **ITEM 1A. RISK FACTORS**



### **Cautionary Statement on Forward-Looking Statements**

We have made and will make forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 in our 2007 Annual Report, in this Annual Report on Form 10-K and in other contexts relating to future growth and profitability targets and strategies designed to increase total shareholder value. Forward-looking statements also include, but are not limited to, information regarding our future economic and financial condition, the plans and objectives of our management and our assumptions regarding our performance and these plans and objectives.

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements to encourage companies to provide prospective information, so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the forward-looking statements. We desire to take advantage of the "safe harbor" provisions of that Act.

Some forward-looking statements that we make in our 2007 Annual Report, in this Annual Report on Form 10-K and in other contexts represent challenging goals for our Company, and the achievement of these goals is subject to a variety of risks and assumptions and numerous factors beyond our control. Important factors that could cause actual results to differ materially from the forward-looking statements we make are described below. All forward-looking statements attributable to us or persons working on our behalf are expressly qualified in their entirety by the following cautionary statements.

### **Commodity Cost Pressures**

Our ability to manage our cost structure can be adversely affected by movements in commodity and other raw material prices, such as those experienced in fiscal 2007. Market conditions may limit the Company's ability to raise selling prices to offset increases in our input and distribution costs. The uniqueness of our technologies can limit our ability to locate or utilize alternative inputs for certain products. For certain inputs, new sources of supply may have to be qualified under regulatory standards, which can require additional investment and delay bringing a product to market.

### **Competition**

Each of our segments participates in markets that are highly competitive. Many of our competitors sell their products at prices lower than ours. The most price sensitive segment of our category may be more likely to trade down to lower price point products in a more challenging economic environment. We compete primarily on the basis of product innovation, product quality, product performance, value, brand strength, supply chain competency, field sales support and advertising. Some of our competitors have significant financial resources. The strong competition that we face in all of our markets may prevent us from achieving our revenue goals, which may have a material adverse affect on our financial condition and results of operations.

### **Environmental/Socio-Political**

Local, state, federal and foreign laws and regulations relating to environmental matters affect us in several ways. In the United States, all products containing pesticides must be registered with the U.S. EPA (and similar state agencies) before they can be sold. The inability to obtain or the cancellation of any such registration could have an adverse effect on our business, the severity of which would depend on the products involved, whether another product could be substituted and whether our competitors were similarly affected. We attempt to anticipate regulatory developments and maintain registrations of, and access to, substitute active ingredients, but there can be no assurance that we will continue to be able to avoid or minimize these risks.

The Food Quality Protection Act, enacted by the U.S. Congress in August 1996, establishes a standard for food-use pesticides, which standard is the reasonable certainty that no harm will result from the cumulative effects of pesticide exposures. Under this Act, the U.S. EPA is evaluating the cumulative risks from dietary and non-dietary exposures to pesticides. The pesticides in our products, certain of which may be used on crops processed into various food products, are typically manufactured by independent third parties and continue to be evaluated by the U.S. EPA as part of this exposure risk assessment. The U.S. EPA or the third party registrant may decide that a pesticide we use in our products will be limited or made unavailable to us. For example, in December 2000, the U.S. EPA reached

agreement with various parties, including manufacturers of the active ingredient diazinon, regarding a phased withdrawal from retailers by December 2004 of residential uses of products containing diazinon, also used in our lawn and garden products. We cannot predict the outcome or the severity of the effect of their continuing evaluations.

In addition, the use of certain pesticide and fertilizer products is regulated by various local, state, federal and foreign environmental and public health agencies. These regulations may include requirements that only certified or professional users apply the product or that certain products be used only on certain types of locations, may require users to post notices on properties to which products have

been or will be applied, may require notification to individuals in the vicinity that products will be applied in the future or may ban the use of certain ingredients. Even if we are able to comply with all such regulations and obtain all necessary registrations, we cannot assure you that our products, particularly pesticide products, will not cause injury to the environment or to people under all circumstances. The costs of compliance, remediation or products liability have adversely affected operating results in the past and could materially affect future quarterly or annual operating results.

Perceptions that the products we produce and market are not safe could adversely affect us and contribute to the risk we will be subjected to legal action. We manufacture and market a number of complex chemical products, such as fertilizers, growing media, herbicides and pesticides. On occasion, allegations are made that some of our products have failed to perform up to expectations or have caused damage or injury to individuals or property. Based on reports of contamination at a third party supplier's vermiculite mine, the public may perceive that some of our products manufactured in the past using vermiculite are or may be contaminated. Public perception that our products are not safe, whether justified or not, could impair our reputation, involve us in litigation, damage our brand names and have a material adverse affect on our business.

The harvesting of peat for our growing media business has come under increasing regulatory and environmental scrutiny. In the United States, state regulations frequently require us to limit our harvesting and to restore the property to an agreed-upon condition. In some locations, we have been required to create water retention ponds to control the sediment content of discharged water. In the United Kingdom, our peat extraction efforts are also the subject of legislation.

In addition to the regulations already described, local, state, federal and foreign agencies regulate the disposal, handling and storage of waste, air and water discharges from our facilities.

The adequacy of our current environmental reserves and future provisions is based on our operating in substantial compliance with applicable environmental and public health laws and regulations and several significant assumptions:

that we have identified all of the significant sites that must be remediated;

that there are no significant conditions of potential contamination that are unknown to us; and

that with respect to the agreed judicial consent order in Ohio relating to the remediation of the Marysville site, the potentially contaminated soil can be remediated in place rather than having to be removed and only specific stream segments will require remediation as opposed to the entire stream.

If there is a significant change in the facts and circumstances surrounding these assumptions or if we are found not to be in substantial compliance with applicable environmental and public health laws and regulations, it could have a material impact on future environmental capital expenditures and other environmental expenses and our results of operations, financial position and cash flows.

## **Manufacturing**

We use a combination of internal and outsourced facilities to manufacture our products. We are subject to the inherent risks in such activities, including product quality, safety, licensing requirements and other regulatory issues, environmental events, loss or impairment of key manufacturing sites, disruptions in logistics, labor disputes and industrial accidents. Furthermore, we are subject to natural disasters and other factors over which the Company has no control.

## **Customer Concentration**

In the North America segment, net sales represented approximately 70% of our worldwide net sales in fiscal 2007. Our top three North American retail customers together accounted for 60% of our North America segment fiscal 2007 net sales and 60% of our outstanding accounts receivable as of September 30, 2007. Home Depot, Lowe's and Wal\*Mart represented approximately 29%, 16% and 15%, respectively, of our fiscal 2007 North America net sales. The loss of, or reduction in orders from, Home Depot, Lowe's, Wal\*Mart or any other significant customer could have a material adverse effect on our business and our financial results, as could customer disputes regarding shipments, fees, merchandise condition or related matters. Our inability to collect accounts receivable from any of these customers could also have a material adverse affect on our financial condition and results of operations.

We do not have long-term sales agreements or other contractual assurances as to future sales to any of our major retail customers. In addition, continued consolidation in the retail industry has resulted in an increasingly concentrated retail base. To the extent such concentration continues to occur, our net sales and income from operations may be increasingly sensitive to deterioration in the financial condition of, or other adverse developments involving our relationship with, one or more customers.

### **Weather and Seasonality**

Weather conditions in North America and Europe can have a significant impact on the timing of sales in the spring selling season and overall annual sales. An abnormally wet and/or cold spring throughout North America or Europe could adversely affect both fertilizer and pesticide sales and, therefore, our financial results. Because our products are used primarily in the spring and summer, our business is highly seasonal. For the past three fiscal years, 70% to 75% of our annual net sales have occurred in the second and third fiscal quarters combined. Our working capital needs and borrowings typically peak during the initial weeks of our third fiscal quarter because we are incurring expenditures in preparation for the spring selling season while the majority of our revenue collections occur later in our third fiscal quarter. If cash on hand is insufficient to pay our obligations as they come due, including interest payments or operating expenses, at a time when we are unable to draw on our credit facilities, this seasonality could have a material adverse effect on our ability to conduct our business. Adverse weather conditions could heighten this risk.

### **Debt**

We have a significant amount of debt that could adversely affect our financial health and prevent us from fulfilling our obligations. Our substantial indebtedness could have important consequences. For example, it could:

- make it more difficult for us to satisfy our obligations under outstanding indebtedness;

- increase our vulnerability to general adverse economic and industry conditions;

- require us to dedicate a substantial portion of cash flows from operating activities to payments on our indebtedness, which would reduce the cash flows available to fund working capital, capital expenditures, advertising, research and development efforts and other general corporate requirements;

- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;

- place us at a competitive disadvantage compared to our competitors that have less debt;

- limit our ability to borrow additional funds; and

- expose us to risks inherent in interest rate fluctuations because some of our borrowings are at variable rates of interest, which could result in higher interest expense in the event of increases in interest rates.

Our ability to make payments and to refinance our indebtedness, to fund planned capital expenditures and acquisitions, and to pay dividends will depend on our ability to generate cash in the future. This, to some extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

We cannot provide assurance that our business will generate sufficient cash flow from operating activities or that future borrowings will be available to us under our credit facilities in amounts sufficient to enable us to pay our

indebtedness or to fund our other liquidity needs. We may need to refinance all or a portion of our indebtedness, on or before maturity. We cannot assure you that we would be able to refinance any of our indebtedness on commercially reasonable terms or at all.

Our credit facilities contain restrictive covenants and cross default provisions that require us to maintain specified financial ratios. Our ability to satisfy those financial ratios can be affected by events beyond our control, and we cannot be assured we will satisfy those ratios. A breach of any of these financial ratio covenants or other covenants could result in a default. Upon the occurrence of an event of default, the lenders could elect to declare the applicable outstanding indebtedness due immediately

and payable and terminate all commitments to extend further credit. We cannot be sure that our lenders would waive a default or that we could pay the indebtedness in full if it were accelerated.

### **Foreign Operations and Currency Exposures**

We currently operate manufacturing, sales and service facilities outside of the United States, particularly in Canada, France, the United Kingdom, Germany and the Netherlands. In fiscal 2007, International net sales, including Canada, accounted for approximately 21% of our total net sales. Accordingly, we are subject to risks associated with operations in foreign countries, including:

fluctuations in currency exchange rates;

limitations on the remittance of dividends and other payments by foreign subsidiaries;

additional costs of compliance with local regulations; and

historically, in certain countries, higher rates of inflation than in the United States.

In addition, our operations outside the United States are subject to the risk of new and different legal and regulatory requirements in local jurisdictions, potential difficulties in staffing and managing local operations and potentially adverse tax consequences. The costs related to our International and Canadian operations could adversely affect our operations and financial results in the future.

### **Acquisitions**

From time to time we make strategic acquisitions, including the October 2004 acquisition of Smith & Hawken®, the October 2005 acquisition of Rod McLellan Company (RMC), the November 2005 acquisition of Gutwein (Morning Song®), the May 2006 acquisition of certain assets of Turf-Seed, Inc. and the June 2006 acquisition of certain assets of Landmark Seed Company. Acquisitions have inherent risks, such as obtaining necessary regulatory approvals, retaining key personnel, integration of the acquired business, and achievement of planned synergies and projections. We have approximately \$880 million of goodwill and intangible assets as of September 30, 2007, primarily related to prior acquisitions. Uncertainty regarding the future performance of the acquired businesses also results in the risk of future impairment charges related to the associated goodwill and intangible assets, such as the impairment charge recorded in fiscal 2007 relating to our investment in Smith & Hawken®.

### **Significant Agreement**

If we were to commit a serious default under the Marketing Agreement with Monsanto for consumer Roundup® products, Monsanto may have the right to terminate the Marketing Agreement. If Monsanto were to terminate the Marketing Agreement for cause, we would not be entitled to any termination fee, and we would lose all, or a significant portion, of the significant source of earnings and overhead expense absorption the Marketing Agreement provides. Monsanto may also be able to terminate the Marketing Agreement within a given region, including North America, without paying us a termination fee if 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.

### **Equity Ownership Concentration**

Hagedorn Partnership, L.P. beneficially owned approximately 32% of our outstanding common shares as of November 23, 2007, and has sufficient voting power to significantly influence the election of directors and the



approval of other actions requiring the approval of our shareholders.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None

**ITEM 2. PROPERTIES**

We lease land from the Union County Community Improvement Corporation in Marysville, Ohio for our headquarters and for our research and development facilities. We own property in Marysville, Ohio for our manufacturing and distribution facilities. Combined, these facilities are situated on approximately 750 acres of land.

The North America segment owns two additional research facilities located in Apopka, Florida; and Gervais, Oregon. We own a production facility, which encompasses 27 acres, in Fort Madison, Iowa and lease a spreader and other durable components manufacturing facility in Temecula, California. We also lease a controlled-release fertilizer manufacturing facility in Charleston, South Carolina. We operate 27 growing media facilities in North America 22 of which are owned by us and 5 of which are leased. Most of our growing media facilities include production lines, warehouses, offices and field processing areas. We lease sales offices in Atlanta, Georgia; Mooresville, North Carolina; Rolling Meadows, Illinois; and Bentonville, Arkansas. We also lease a facility in Mississauga, Ontario that serves as the headquarters for our Canadian subsidiary. We own 6 seed production facilities; one for grass seed in Albany, Oregon and 5 for wild bird food in Indiana, South Dakota, South Carolina and Texas.

Scotts LawnService® conducts its company-owned operations from 78 leased facilities, primarily office/warehouse units in industrial/office parks, across the United States serving 46 metropolitan markets.

Smith & Hawken® operates 61 retail stores, which are all leased facilities primarily in shopping centers across the United States. It leases its main headquarters in Novato, California.

The International segment leases its U.K. office, located in Godalming (Surrey); its French headquarters and local operations office, located in Ecully (Lyon); a German office, located in Ingelheim; an Austrian office, located in Salzburg; an Australian office, located in Baulkan Hills (New South Wales); a Belgium sales office, located in Sint Niklaas; and a Netherlands office for its professional business, located in Waardenburg. We own manufacturing facilities in Howden, Hatfield (East Yorkshire) and Sutton Bridge, in the United Kingdom. We also own a blending and bagging facility for growing media in Hautmont, France; and a plant in Bourth, France, that we use for formulating, blending and packaging control products for the consumer market. Our site in Heerlen, the Netherlands includes a research facility, a distribution center and a manufacturing site for coated fertilizers for the consumer and professional markets. We own the land and the building for the manufacturing facility, but lease the distribution center building. We lease a research and development facility in Chazay, France. In the United Kingdom, we own a research and development facility in Levington and we lease a research and development facility in Bramford.

We lease warehouse space throughout North America and continental Europe as needed.

We believe that our facilities are adequate to serve their intended purposes at this time and that our property leasing arrangements are satisfactory.

### **ITEM 3. LEGAL PROCEEDINGS**

As noted in the discussion in ITEM 1. BUSINESS Environmental and Regulatory Considerations and ITEM 1. BUSINESS Regulatory Actions, we are involved in several pending environmental matters. We believe that our assessment of contingencies is reasonable and that related reserves, in the aggregate, are adequate; however, there can be no assurance that the final resolution of these matters will not have a material adverse affect on our results of operations, financial position and cash flows.

Pending significant legal proceedings are as follows:

#### **U.S. Horticultural Supply, Inc. (F/K/A E.C. Geiger, Inc.)**

On November 5, 2004, U.S. Horticultural Supply, Inc. ( Geiger ) filed suit against the Company in the U.S. District Court for the Eastern District of Pennsylvania. This complaint alleges that the Company conspired with another distributor, Griffin Greenhouse Supplies, Inc., to restrain trade in the horticultural products market, in violation of Section 1 of the Sherman Antitrust Act. On June 2, 2006, the Court denied the Company's motion to dismiss the

complaint. Fact discovery ended on March 8, 2007. The Company is currently engaged in expert discovery, the deadline for completion of which is December 7, 2007. Geiger's damages expert quantifies Geiger's alleged damages at approximately \$3.3 million, which could be trebled under the antitrust laws. The deadline for dispositive motions is January 17, 2008.

The Company continues to vigorously defend against Geiger's claims. The Company believes that Geiger's claims are without merit and that the likelihood of an unfavorable outcome is remote. Therefore, no accrual has been established related to this matter. However, the Company cannot predict the ultimate outcome with certainty. If the above action is determined adversely to the Company, the result could have a material adverse effect on the Company's results of operations, financial position and cash

flows. The Company had previously sued and obtained a judgment against Geiger on April 25, 2005, based on Geiger's default on obligations to the Company, and the Company is proceeding to collect that judgment.

### **The Scotts Company LLC v. Liberty Mutual Insurance Company**

On October 25, 2006, Scotts LLC (as successor to Scotts) sued Liberty Mutual Insurance Company (Liberty Mutual) in the U.S. District Court for the Southern District of Ohio. In the suit, Scotts LLC seeks damages and the rescission of a 2000 agreement between Scotts and Liberty Mutual that purports to be a complete buyout by Scotts of any insurance policies that Liberty Mutual might have issued to Scotts (the 2000 Agreement).

As alleged in Scotts LLC's complaint, in 1998, Scotts tendered certain claims to Liberty Mutual, one of its primary-layer insurers, in connection with costs incurred by Scotts for environmental liabilities. Scotts believed that it had coverage from Liberty Mutual for at least 10 years beginning in 1958 but could only locate a single policy from 1967. Liberty Mutual responded to Scotts' tender by stating that, after conducting an internal search, Liberty Mutual did not have sufficient evidence to establish that it had ever insured Scotts before 1967. Based on Liberty Mutual's representations and Scotts' inability to locate any additional Liberty Mutual policies in Scotts' own files, Scotts eventually entered into the 2000 Agreement. According to Scotts LLC's complaint, in Fall 2006, Scotts LLC discovered evidence confirming that, contrary to Scotts' representations during the negotiations leading to the 2000 Agreement, Liberty Mutual provided liability insurance to Scotts beginning in at least 1958 and, in fact, paid claims to third parties on Scotts' behalf during that period.

The complaint seeks rescission of the 2000 Agreement and seeks damages based on Liberty Mutual's breach of fiduciary duty, fraud, breach of the implied covenant of good faith and fair dealing, and bad faith denial of coverage. Scotts LLC intends to prosecute these claims vigorously. Liberty Mutual has filed an answer that denies the complaint's allegations. Discovery recently began in the case and the Court has not set a trial date.

### **Other**

The Company has been named 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. The complaints in these cases are not specific about the plaintiffs' contacts with the Company or its products. The Company in each case is one of numerous defendants and none of the claims seeks damages from the Company alone. The Company believes that the claims against it are without merit and is vigorously defending them. It is not currently possible to reasonably estimate a probable loss, if any, associated with the cases and, accordingly, no accrual or reserves have been recorded in the Company's consolidated financial statements. 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 adverse effect on the Company's financial condition, results of operations or cash flows.

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.

On April 27, 2007, the Company received a proposed Order On Consent from the New York State Department of Environmental Conservation (the Proposed Order) alleging that during the calendar year 2003, the Company and James Hagedorn, individually and as Chairman of the Board and the Chief Executive Officer of the Company, unlawfully donated to a Port Washington, New York youth sports organization forty bags of Scotts® LawnPro Annual Program Step 3 Insect Control Plus Fertilizer which, while federally registered, was allegedly not registered in the state of New York. The Proposed Order requests penalties totaling \$695,000. The Company has made its position clear to the New York State Department of Environmental Conservation and is awaiting a response.

On November 26, 2007, the United States Department of Agriculture issued an administrative complaint alleging that Scotts LLC had violated the Plant Protection Act and the regulations promulgated thereunder, related to the testing of genetically-modified Glyphosate-tolerant creeping bentgrass. Without admitting or denying that it violated the law, on November 26, 2007, Scotts LLC entered into a Consent Decision and Order with the USDA resolving this matter. The Company has agreed to pay a civil penalty of \$500,000, which had previously been accrued, and conduct three public workshops.

We are involved in other lawsuits and claims which arise in the normal course of our business. In our opinion, these claims individually and in the aggregate are not expected to result in a material adverse effect on our results of operations, financial position or cash flows.

#### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no matters submitted to a vote of the security holders of The Scotts Miracle-Gro Company during the fourth quarter of fiscal 2007.

#### **SUPPLEMENTAL ITEM. EXECUTIVE OFFICERS OF THE REGISTRANT**

The executive officers of The Scotts Miracle-Gro Company, their positions and, as of November 23, 2007 their ages and years with The Scotts Miracle-Gro Company (and its predecessors) are set forth below.

Name	Age	Position(s) Held	Years with Company
James Hagedorn	52	President, Chief Executive Officer and Chairman of the Board	20
David C. Evans	44	Executive Vice President and Chief Financial Officer	14
Denise S. Stump	53	Executive Vice President, Global Human Resources	7
Barry W. Sanders	43	Executive Vice President, North America	6
Claude Lopez	46	Executive Vice President, International and Chief Marketing Officer	6

Executive officers serve at the discretion of the Board of Directors and pursuant to employment agreements or other arrangements.

The business experience of each of the individuals listed above during at least the past five years is as follows:

Mr. Hagedorn has been serving as the Chairman of the Board of the Company since January 2003; as Chief Executive Officer of the Company since May 2001 and as President of the Company since November 2006 and from May 2001 until December 2005. The Scotts Miracle-Gro Company became the public company successor to The Scotts Company which was merged into The Scotts Company LLC in March 2005. He also serves as a director for Farms For City Kids Foundation, Inc., Nurse Family Partnership, The CDC Foundation, Embry Riddle/Aeronautical University, Northshore University Hospital (New York), Scotts Miracle-Gro Foundation and the Intrepid Sea-Air-Space Museum, all charitable organizations. Mr. Hagedorn is the brother of Katherine Hagedorn Littlefield, a director of The Scotts Miracle-Gro Company.

Mr. Evans was named Executive Vice President and Chief Financial Officer of The Scotts Miracle-Gro Company on September 14, 2006. From October 2005 to September 2006, he served as Senior Vice President, Finance and Global Shared Services of The Scotts Company LLC. From October 2003 to March 2005, he served as Senior Vice President, North America of The Scotts Company and from March 2005 to September 2005, he served in the same capacity for The Scotts Company LLC following the merger of The Scotts Company into The Scotts Company LLC. From June 2001 to September 2003, he served as Vice President, Finance, North America Sales of The Scotts Company.

Ms. Stump was named Executive Vice President, Global Human Resources of The Scotts Miracle-Gro Company in March 2005. Ms. Stump was named Executive Vice President, Global Human Resources of The Scotts Company in February 2003, which was merged into The Scotts Company LLC in March 2005. She was named Senior Vice President, Global Human Resources of The Scotts Company in October 2002. From July 2001 until October 2002, Ms. Stump served as Vice President, Human Resources North America, of The Scotts Company. From September 2000 until July 2001, Ms. Stump served as Vice President, Human Resources Technology and Operations, of The Scotts Company.

Mr. Sanders was named Executive Vice President, North America of The Scotts Miracle-Gro Company in September 2007. From January 25, 2005 until September 2007, he served as Executive Vice President

of Global Technologies and Operations of the Scotts Miracle-Gro Company, responsible for the Company's supply chain, information systems as well as research and development efforts. He previously led the North American and global supply chain organizations as well as the North American sales force. In 2005, he ran the Smith & Hawken® business on an interim basis. Prior to joining the Company in 2001, he was a partner with CapGemini/Ernst & Young.

Mr. Lopez was named Executive Vice President, International and Chief Marketing Officer of The Scotts Miracle-Gro Company in October 2007. Mr. Lopez leads marketing for all global consumer-facing business. He also has leadership responsibility for the Company's Global Professional and Pro Seed businesses. In September 2007, he was named Senior Vice President, International and Chief Marketing Officer of The Scotts Miracle-Gro Company. From December 2004 until September 2007, Mr. Lopez served as Senior Vice President, International of The Scotts Miracle-Gro Company. From the time Mr. Lopez joined the Company in 2001 until December 2004, he served as general manager of the Company's French business.



**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The common shares of The Scotts Miracle-Gro Company ( Scotts Miracle-Gro ) trade on the New York Stock Exchange under the symbol SMG. The quarterly high and low closing prices, which have not been adjusted for the special one-time cash dividend of \$8.00 per share described below, for the fiscal years ended September 30, 2007 and 2006 were as follows:

	Sale Prices	
	High	Low
FISCAL 2007		
First quarter	\$ 54.72	\$ 44.02
Second quarter	\$ 57.45	\$ 40.57
Third quarter	\$ 47.30	\$ 42.80
Fourth quarter	\$ 49.69	\$ 40.60
FISCAL 2006		
First quarter	\$ 48.11	\$ 41.37
Second quarter	\$ 50.47	\$ 44.94
Third quarter	\$ 47.50	\$ 39.40
Fourth quarter	\$ 44.98	\$ 37.22

On June 22, 2005, Scotts Miracle-Gro announced that its Board of Directors had approved the establishment of a quarterly cash dividend. The \$0.50 per share (adjusted for the 2-for-1 stock split distributed November 9, 2005) annual dividend has been paid in quarterly increments since the fourth quarter of fiscal 2005. In addition, the Company paid a special one-time cash dividend of \$8.00 per share on March 5, 2007. The payment of future dividends, if any, on the common shares will be determined by the Board of Directors of Scotts Miracle-Gro in light of conditions then existing, including the Company's earnings, financial condition and capital requirements, restrictions in financing agreements, business conditions and other factors. Future dividend payments are currently restricted to \$55 million annually under our existing credit facilities. See discussion regarding the recapitalization plan executed in the second quarter of fiscal 2007 in ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. Note 10 to the Consolidated Financial Statements included in this Annual Report on 10-K provides further discussion regarding the restrictions on dividend payments.

As of November 19, 2007, there were approximately 37,000 shareholders including holders of record and our estimate of beneficial holders.

There were no purchases of common shares of Scotts Miracle-Gro made by or on behalf of Scotts Miracle-Gro or any affiliated purchaser of Scotts Miracle-Gro as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934 for each of the three months in the quarter ended September 30, 2007.

Scotts Miracle-Gro has recently determined that during a period between October, 2006 and November 14, 2007, the trustee of the Smith & Hawken 401(k) Plan purchased for the Smith & Hawken 401(k) Plan 649 common shares of Scotts Miracle-Gro which were not registered in accordance with the Securities Act of 1933, as amended (the Securities Act ). Although all purchases made by the trustee of the Smith & Hawken 401(k) Plan for the Smith &

Hawken 401(k) Plan were made in the open market and in a manner consistent with the Smith & Hawken 401(k) Plan and the investment elections of the Smith & Hawken 401(k) Plan participants, because the common shares of Scotts Miracle-Gro purchased by the Smith & Hawken 401(k) Plan trustee for the Smith & Hawken 401(k) Plan were not registered, the Smith & Hawken 401(k) Plan participants may have a right to rescind their purchases made through the Smith & Hawken 401(k) Plan. Scotts Miracle-Gro believes that damages resulting from successful claims against Scotts Miracle-Gro for its failure to register the Scotts Miracle-Gro common shares that were purchased through the Smith & Hawken 401(k) Plan would have a negligible effect on Scotts Miracle-Gro. At this time, Scotts Miracle-Gro does not intend to make a rescission offer to participants in the Smith & Hawken 401(k) Plan.

**ITEM 6. SELECTED FINANCIAL DATA**

**Five-Year Summary(1)**  
**For the fiscal year ended September 30,**  
**(in millions, except per share amounts)**

	2007	2006(2)	2005(2)	2004	2003
<b>OPERATING RESULTS(3):</b>					
Net sales	\$ 2,871.8	\$ 2,697.1	\$ 2,369.3	\$ 2,106.5	\$ 1,941.6
Gross profit	1,004.5	955.9	860.4	792.4	701.7
Income from operations	277.1	252.5	200.9	252.8	231.6
Income from continuing operations (net of tax)	113.4	132.7	100.4	100.5	103.2
Net income	113.4	132.7	100.6	100.9	103.8
Depreciation and amortization	67.5	67.0	67.2	57.7	52.2
<b>FINANCIAL POSITION:</b>					
Working capital	412.7	445.8	301.6	396.7	364.4
Current ratio	1.7	1.9	1.6	1.9	1.8
Property, plant and equipment, net	365.9	367.6	337.0	328.0	338.2
Total assets	2,277.2	2,217.6	2,018.9	2,047.8	2,030.3
Total debt to total book capitalization(4)	70.0%	30.8%	27.7%	41.9%	51.0%
Total debt	1,117.8	481.2	393.5	630.6	757.6
Total shareholders' equity	479.3	1,081.7	1,026.2	874.6	728.2
<b>CASH FLOWS:</b>					
Cash flows from operating activities	246.6	182.4	226.7	214.2	216.1
Investments in property, plant and equipment	54.0	57.0	40.4	35.1	51.8
Investments in acquisitions, including seller note payments	21.4	122.9	84.6	20.5	57.1
<b>PER SHARE DATA:</b>					
Basic earnings per common share	\$ 1.74	\$ 1.97	\$ 1.51	\$ 1.56	\$ 1.68
Diluted earnings per common share	1.69	1.91	1.47	1.52	1.62
Total cash dividends paid	543.6	33.5	8.6		
Regular cash dividends per share(5)	\$ 0.50	\$ 0.50	\$ 0.125		
Special cash dividend per share(6)	8.00				
Stock price at year-end(6)	42.75	44.49	43.97	32.08	27.35
Stock price range High(6)	57.45	50.47	43.97	34.28	28.85
Stock price range Low(6)	40.57	37.22	30.95	27.63	21.77
<b>OTHER:</b>					

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Adjusted EBITDA(7)	382.6	385.9	291.5	310.5	283.8
Interest coverage (Adjusted EBITDA/interest expense)(7)	5.4	9.7	7.0	6.4	4.1
Weighted average common shares outstanding	65.2	67.5	66.8	64.7	61.8
Common shares and dilutive potential common shares used in diluted EPS calculation	67.0	69.4	68.6	66.6	64.3

- (1) All common share and per share information presented in the above five-year summary have been adjusted to reflect the 2-for-1 stock split of the common shares which was distributed on November 9, 2005 to shareholders of record on November 2, 2005.
- (2) Fiscal 2006 includes Rod McLellan Company, Gutwein & Co., Inc. and certain brands and assets acquired from Turf-Seed, Inc. and Landmark Seed Company from the dates of acquisition. Fiscal 2005 includes Smith & Hawken® from the October 2, 2004 date of acquisition. See further

discussion of acquisitions in Note 7 to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

- (3) Operating results includes the following items segregated by accounts impacted on the Consolidated Statements of Operations included with the Consolidated Financial Statements included in this Annual Report on Form 10-K.

	For the Fiscal Year Ended September 30,				
	2007	2006	2005	2004	2003
Net sales includes the following relating to the Roundup® Marketing Agreement:					
Net commission income (expense)	\$ 41.9	\$ 39.9	\$ (5.3)	\$ 28.5	\$ 17.6
Reimbursements associated with the Roundup® Marketing Agreement	47.7	37.6	40.7	40.1	36.3
Deferred contribution charge (see Note 4 to the Consolidated Financial Statements included in this Annual Report on Form 10-K)			(45.7)		
Cost of sales includes:					
Costs associated with the Roundup® Marketing Agreement	47.7	37.6	40.7	40.1	36.3
Restructuring and other charges (income)		0.1	(0.3)	0.6	9.1
Selling, general and administrative includes:					
Restructuring and other charges	2.7	9.3	9.8	9.1	8.0
Impairment charges	35.3	66.4	23.4		
Interest expense includes:					
Costs related to refinancings	18.3		1.3	45.5	

- (4) The total debt to total book capitalization percentage is calculated by dividing total debt by total debt and shareholders' equity.
- (5) The Company began paying a quarterly dividend of 12.5 cents per share in the fourth quarter of fiscal 2005.
- (6) The Company paid a special one-time cash dividend of \$8.00 per share on March 5, 2007. Stock prices have not been adjusted for this special one-time cash dividend.
- (7) Given our significant borrowings, we view our credit facilities as material to our ability to fund operations, particularly in light of our seasonality. Reference should be made to ITEM 1A. RISK FACTORS, in this Annual Report on Form 10-K for a more complete discussion of risks associated with the Company's debt and our credit facilities and related covenants. Our ability to generate cash flows sufficient to cover our debt service costs is essential to our ability to maintain our borrowing capacity. We believe that Adjusted EBITDA provides additional information for determining our ability to meet debt service requirements. The presentation of Adjusted EBITDA herein is intended to be consistent with the calculation of that measure as required by our borrowing arrangements, and used to calculate a leverage ratio (maximum of 4.75 at September 30, 2007) and an interest coverage ratio (minimum of 2.75 for the year ended September 30, 2007). The Company's leverage ratio was 3.56 at September 30, 2007 and our interest coverage ratio was 5.4 for the year ended September 30, 2007.

In accordance with the terms of our credit facilities, Adjusted EBITDA is defined as net income before interest, taxes, depreciation and amortization, as well as certain other items such as the impact of discontinued operations, the cumulative effect of changes in accounting, costs associated with debt refinancings, and other non-recurring, non-cash items effecting net income. Adjusted EBITDA does not represent and should not be considered as an alternative to net income or cash flow from operations as determined by accounting principles generally accepted in the United States of America, and Adjusted EBITDA does not necessarily indicate whether cash flow will be sufficient to meet cash requirements. Interest coverage is calculated as Adjusted EBITDA divided by interest expense excluding costs related to refinancings.

A numeric reconciliation of net income to Adjusted EBITDA is as follows:

	2007	2006	2005	2004	2003
Net income	\$ 113.4	\$ 132.7	\$ 100.6	\$ 100.9	\$ 103.8
Interest	70.7	39.6	41.5	48.8	69.2
Income taxes	74.7	80.2	57.7	58.0	59.2
Deprecation and amortization	67.5	67.0	67.2	57.7	52.2
Impairment, restructuring and other charges	38.0	66.4	23.4		
Discontinued operations			(0.2)	(0.4)	(0.6)
Costs related to refinancings	18.3		1.3	45.5	
Adjusted EBITDA	\$ 382.6	\$ 385.9	\$ 291.5	\$ 310.5	\$ 283.8

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The purpose of this discussion is to provide an understanding of the financial results and condition of The Scotts Miracle-Gro Company ( Scotts Miracle-Gro ) and its subsidiaries (collectively, the Company ) by focusing on changes in certain key measures from year to year. Management's Discussion and Analysis ( MD&A ) is organized in the following sections:

Executive summary

Results of operations

Management's outlook

Liquidity and capital resources

Critical accounting policies and estimates

### **Executive Summary**

We are dedicated to delivering strong, consistent financial results and outstanding shareholder returns by providing consumers with products of superior quality and value to enhance their outdoor living environments. We are a leading manufacturer and marketer of consumer branded products for lawn and garden care and professional horticulture in North America and Europe. We are Monsanto's exclusive agent for the marketing and distribution of consumer Roundup® non-selective herbicide products within the United States and other contractually specified countries. We entered the North America wild bird food category with the acquisition of Gutwein & Co., Inc. ( Gutwein ) in November 2005, and the outdoor living category with the acquisition of Smith & Hawken® in October 2004. We have a presence in Australia, the Far East, Latin America and South America. Also, in the United States, we operate the second largest residential lawn service business, Scotts LawnService®. In fiscal 2007, our operations continued to be divided into the following reportable segments: North America, Scotts LawnService®, International, and Corporate & Other. The Corporate & Other segment consists of the Smith & Hawken® business and unallocated corporate general

and administrative expenses.

As a leading consumer branded lawn and garden company, we focus our consumer marketing efforts, including advertising and consumer research, on creating consumer demand to pull products through the retail distribution channels. In the past three years, we have spent approximately 5% of our net sales annually on media advertising to support and promote our products and brands. We have applied this consumer marketing focus for a number of years, and believe that we receive a significant return on these marketing expenditures. We expect continued focus on consumer oriented marketing with additional targeted investments in consumer marketing expenditures to continue driving market share and sales growth.

Weather conditions can have an impact on our sales. For instance, periods of wet weather can adversely impact sales of certain products, while increasing demand for other products. During fiscal 2007, our sales were adversely impacted by cold weather during the critical April selling period in North America and by an abnormally dry summer in the southeast United States. We believe that our past acquisitions have somewhat diversified both our product line risk and geographic risk to weather conditions.



	Percent of Net Sales by Quarter		
	2007	2006	2005
First Quarter	9.5%	9.3%	10.4%
Second Quarter	34.6%	33.6%	34.3%
Third Quarter	38.2%	38.9%	38.0%
Fourth Quarter	17.7%	18.2%	17.3%

Due to the nature of our lawn and garden business, significant portions of our shipments occur in the second and third fiscal quarters. Retailers continue to place reliance on our ability to deliver products in season when consumer demand is the highest in order to help mitigate the need to carry large seasonal inventories.

Management focuses on a variety of key indicators and operating metrics to monitor the health and performance of our business. These metrics include consumer purchases (point-of-sale data), category growth, market share, net sales (including volume, pricing and foreign exchange), gross profit margin rates, income from operations, net income and earnings per share. To the extent applicable, these measures are evaluated with and without impairment, restructuring and other charges. We also focus on measures to optimize cash flow and return on invested capital, including the management of working capital and capital expenditures.

Our consumer International business was a strength during fiscal 2007 with improved performance in every major market. Over the past several years, we have reorganized and rationalized our European supply chain and increased sales force productivity. Current efforts are focused on improving our competitive position, continuing to reduce supply chain and SG&A costs within this segment, and realigning the organization to better leverage our knowledge of the marketplace and the consumer. We are working towards pan-European category management of our consumer product portfolio. Now that we have shown we can succeed in Europe, we intend to make necessary investments to continue to win with consumers and our retail partners.

We view strategic acquisitions as a means to enhance our strong core businesses, and were successful in completing several such acquisitions during fiscal 2006. Rod McLellan Company ( RMC ), a leading branded producer and marketer of soil and landscape products in the western U.S., was acquired and integrated into our existing Growing Media business. Gutwein, a leader in the growing North America wild bird food category, also was acquired. Gutwein's Morning Song® products are sold at leading mass retailers, grocery, pet and general merchandise stores. This acquisition marked our entry into the wild bird food category that we believe has exciting growth opportunities. Lastly, two additional acquisitions were consummated that have strengthened the Company's overall global position in the turfgrass seed category. First, we acquired certain assets, including brands, turfgrass varieties and intellectual property, from Oregon-based Turf-Seed, Inc. ( Turf-Seed ), a leading producer of quality commercial turfgrasses for the professional seed business. The transaction included a 49% equity interest in Turf-Seed Europe, which distributes Turf-Seed's grass varieties throughout the European Union and other countries in the region. We also acquired certain assets of Oregon-based Landmark Seed Company, a leading producer and distributor of quality professional seed and turfgrasses, including its brands, turfgrass varieties and intellectual property.

Given Scotts Miracle-Gro's strong performance and consistent cash flows, our Board of Directors undertook several actions over the past two years to return cash to our shareholders. We began paying a quarterly cash dividend of 12.5 cents per share in the fourth quarter of fiscal 2005. In fiscal 2006, our Board launched a five-year \$500 million share repurchase program pursuant to which we repurchased 2.0 million common shares for \$87.9 million during fiscal 2006. Most recently, on December 12, 2006, we launched a recapitalization plan to return \$750 million to the

Company's shareholders. This plan expanded and accelerated the previously announced five-year \$500 million share repurchase program (which was canceled). Pursuant to the recapitalization plan, on February 14, 2007, we completed a modified Dutch auction tender offer, resulting in the repurchase of 4.5 million of our common shares for an aggregate purchase price of \$245.5 million (\$54.50 per share). On February 16, 2007, our Board of Directors declared a special one-time cash dividend of \$8.00 per share (\$508 million in the aggregate) which was paid on March 5, 2007, to shareholders of record on February 26, 2007.

In order to fund the recapitalization, we entered into new credit facilities effective February 2007, aggregating \$2.15 billion and terminated our prior credit facility. As part of this debt restructuring, we also conducted a cash tender offer for all of our outstanding 65/8% senior subordinated notes in an aggregate principal amount of \$200 million. Reference should be made to Note 10 to the Consolidated Financial Statements included in this Annual Report on Form 10-K for further information as to the new credit facilities and the repayment and termination of the prior credit facility and the 65/8% senior subordinated notes.

The actions described above reflect management's confidence in the continued growth of the Company. Strong and consistent cash flows can support the higher levels of debt necessary to finance these actions, as discussed in the Liquidity and Capital Resources section of this MD&A. Even with an increase in borrowings as a result of the fiscal 2007 recapitalization transactions, we believe we will maintain the capacity to pursue targeted, strategic acquisitions that leverage our core competencies.

### Results of Operations

The following table sets forth the components of income and expense as a percentage of net sales for the three years ended September 30, 2007:

	2007	2006	2005
Net sales	100.0%	100.0%	100.0%
Cost of sales	65.0	64.6	63.7
Gross profit	35.0	35.4	36.3
Operating expenses:			
Selling, general and administrative	24.4	23.6	26.7
Impairment, restructuring and other charges	1.4	2.8	1.4
Other income, net	(0.4)	(0.4)	(0.3)
Income from operations	9.6	9.4	8.5
Costs related to refinancings	0.6		0.1
Interest expense	2.5	1.5	1.8
Income before income taxes	6.5	7.9	6.6
Income taxes	2.6	3.0	2.4
Income from continuing operations	3.9	4.9	4.2
Income from discontinued operations			
Net income	3.9%	4.9%	4.2%

### Net Sales

Consolidated net sales for fiscal 2007 increased 6.3% to \$2.87 billion from \$2.70 billion in fiscal 2006, while for fiscal 2006, net sales increased 13.8% to \$2.70 billion from \$2.37 billion in fiscal 2005. Significantly impacting the rate of sales growth in both years were the following items:

	2007	2006
Net sales growth	6.3%	13.8%
Acquisitions	(1.3)	(5.0)
Impact of \$45.7 million charge in fiscal 2005 associated with deferred contribution liability under Roundup® Marketing Agreement		(1.9)
Foreign exchange rates	(1.6)	0.4
Adjusted net sales growth	3.4%	7.3%

The adjusted net sales increase of 3.4% is reflective of the weather-related challenges we experienced this year in the largest part of our business, the North America segment. Extreme cold and wet weather in April discouraged consumer usage during this key period, and these lost opportunities were not recovered as the weather improved later in the spring. As we moved into the summer, heat and

drought for large portions of the country created difficult lawn care conditions discouraging many of our do-it-yourself consumers from investing in their lawns. While we saw strong growth in the gardening category, in our Scotts LawnService® business, and our International segment, the adverse impact of weather on the important North American lawns business overshadowed these successes.

The adjusted net sales growth of 7.3% in fiscal 2006 was driven by strong growth in our North American consumer business and the Scotts LawnService® business. In contrast, a difficult lawn and garden market in Europe during fiscal 2006 contributed to a net sales decline after adjusting for the effect of exchange rates.

### Gross Profit

As a percentage of net sales, gross profit was 35.0% of net sales for fiscal 2007 compared to 35.4% for fiscal 2006. This decline in gross profit percent was due to a 90 basis point decline for the North America segment, due almost entirely to unfavorable product mix. Strong net sales growth in the lower margin wild bird food and growing media businesses, coupled with a net sales decline in our higher margin lawns business, were the drivers behind this decrease. Offsetting this decline in North America were gross profit improvements from Scotts LawnService®, Smith & Hawken® and our International segment.

As a percentage of net sales, gross profit was 35.4% of net sales for fiscal 2006 compared to 36.3% for fiscal 2005. Adjusting for the effect of the \$45.7 million Roundup® contribution charge recorded in fiscal 2005 (see Note 4 to the Consolidated Financial Statements included in this Annual Report on Form 10-K), the fiscal 2005 gross profit rate was 37.5%, 210 basis points higher than fiscal 2006. Acquisitions accounted for 70 basis points of the decline, as the margins of these businesses are below our historical average. Product mix adversely affected margins by 80 basis points, due in part to significant increases in sales of lower margin grass seed and garden soils. Increased costs for fuel and commodities exceeded price increases, resulting in 90 basis point decline in gross margin as a percentage of net sales. The offsetting 30 basis point differential is comprised of miscellaneous other items.

### Selling, General and Administrative Expenses (in millions)

	2007	2006	2005
Advertising	\$ 150.9	\$ 137.3	\$ 122.5
Advertising as a percentage of net sales	5.3%	5.1%	5.2%
Selling, general and administrative (other SG&A)	\$ 519.2	\$ 468.7	\$ 486.6
Stock-based compensation	15.5	15.7	9.9
Amortization of intangibles	15.3	15.2	14.8
	\$ 700.9	\$ 636.9	\$ 633.8

Advertising expenses in fiscal 2007 were \$150.9 million, an increase of \$13.6 million or 9.9% from fiscal 2006. Fiscal 2006 advertising expenses were \$137.3 million, an increase of \$14.8 million or 12.1% from fiscal 2005. On a percentage of net sales basis, advertising expenses were 5.3% of net sales in fiscal 2007, 5.1% in fiscal 2006, and 5.2% in fiscal 2005. The fiscal 2007 increase as a percent of net sales was due to an effort to drive consumer interest and reinvigorate the lawns category following weak net sales performance in April. This strategy continued on into the fourth quarter of fiscal 2007. The percentage of net sales decline in fiscal 2006 versus fiscal 2005 was due to the

shift of some planned increases in traditional media advertising to consumer directed promotions funded via programs with our retail partners, which are accounted for as a reduction to net sales. The combination of higher advertising spending and consumer promotions led to an 18% increase in spending for the North American consumer business in fiscal 2006.

In fiscal 2007, other SG&A spending increased \$50.5 million or 10.8% from fiscal 2006. A sizable increase in Scotts LawnService® infrastructure (\$20.4 million), the adverse effect of foreign exchange rates on spending outside the United States (\$11.3 million), and a nonrecurring benefit in fiscal 2006 (\$10.1 million) for an insurance recovery relating to past legal costs incurred in our defense of lawsuits regarding our use of vermiculite were the primarily drivers behind the increase. Spending on incentives

was at less than target in both fiscal 2007 and fiscal 2006, with the benefit to fiscal 2007 approximating \$10 million. In fiscal 2006, other SG&A spending decreased \$17.9 million or 3.7% from fiscal 2005. This decrease reflects savings from our fiscal 2005 Project Excellence initiative coupled with the \$10.1 million insurance recovery benefit. Partially offsetting these decreases in other SG&A spending were increased spending in support of our rapidly expanding Scotts LawnService® business and \$4.2 million attributable to our wild bird food acquisition early in fiscal 2006.

We began expensing share-based awards commencing with grants issued in fiscal 2003. The majority of our share-based awards vest over three years, with the associated expense recognized ratably over the vesting period. Prior to the fiscal 2006 adoption of Statement of Financial Accounting Standards ( SFAS ) No. 123(R), Share-Based Payment, forfeitures were recognized as incurred. Our stock-based compensation expense now reflects an estimate of forfeitures. The increase in stock-based compensation in fiscal 2006 as compared to fiscal 2005 was primarily attributable to an increase in the number of fiscal 2006 awards to key employees coupled with a higher unit grant value due to our relatively higher stock price, and a forfeiture adjustment in fiscal 2005 that reduced expense in that year by approximately \$2.2 million.

Amortization expense of \$15.3 million in fiscal 2007 is comparable to \$15.2 million in fiscal 2006 and \$14.8 million in fiscal 2005. Strengthening foreign currencies relative to the dollar over the past two years has served to increase amortization expense slightly along with the addition of new amortizing intangibles from acquisitions.

#### **Impairment, Restructuring and Other Charges, net (in millions)**

	2007	2006	2005
Goodwill and intangible asset impairment	\$ 35.3	\$ 66.4	\$ 23.4
Restructuring severance and related		9.3	26.3
Litigation related income			(16.8)
Other	2.7		0.3
	\$ 38.0	\$ 75.7	\$ 33.2

Since its adoption of SFAS 142, Goodwill and Other Intangible Assets , the Company has conducted its annual impairment review of indefinite-lived tradenames and goodwill during its first fiscal quarter. The impairment analysis for the first quarter of fiscal 2007 indicated that no impairment charges were required. During the third quarter of fiscal 2007, the Company changed the timing of its annual goodwill impairment testing from the last day of our fiscal first quarter to the first day of our fiscal fourth quarter. Therefore, we performed our annual impairment test again as of July 1, 2007. Moving the timing of our annual goodwill impairment testing better aligns with the seasonal nature of our business and the timing of our annual strategic planning process. In addition, the Company also changed the date of its annual indefinite life intangible impairment testing to the first day of our fiscal fourth quarter. Management engages an independent valuation firm to assist in its impairment assessment reviews.

Our fourth quarter fiscal 2007 impairment review resulted in a non-cash goodwill and intangible asset impairment charge of \$35.3 million. In part as a result of the disappointing 2007 lawn and garden season, management undertook a comprehensive strategic update of its business initiatives in the fourth quarter of fiscal 2007. One outcome of this update was a decision to increase the focus of Company resources on our core consumer lawn and garden do-it-yourself businesses. This process also involved a re-evaluation of the strategy and cash flow projections surrounding our Smith & Hawken® business, which has consistently performed below expectations since it was

acquired in early fiscal 2005. While management remains committed to the outdoor living category and intends to more vigorously leverage the Smith & Hawken® brand in other lawn and garden categories, we revised our Smith & Hawken® strategy to reflect a scaled back retail expansion plan, with an increased focus on aggressively expanding our wholesale aspect of this business. This resulted in a decrease in our prior cash flow projections for this business, resulting in a \$24.6 million goodwill impairment charge and a \$4.6 million impairment charge for an indefinite-lived tradename. The goodwill impairment charge is an estimate, as appraisals necessary to complete the required SFAS 142 evaluation of the Smith & Hawken® goodwill remain in process as of the date of this report. We will finalize this evaluation in the first quarter of fiscal 2008 and, if necessary, update the impairment charge for Smith & Hawken® goodwill in that reporting period.



Our fiscal 2007 fourth quarter strategic update also encompassed other areas. We remain strongly committed to the development of turfgrass varieties that could one day require less mowing, less water and fewer treatments to resist insects, weeds and disease. Our efforts to develop such turfgrass varieties include conventional breeding programs, as well as research and development involving biotechnology. Our efforts to develop turfgrass varieties involving biotechnology have yielded positive results; however, the required regulatory approval process is taking longer than anticipated, impacting our ability to commercialize our innovations. As result of our fiscal 2007 fourth quarter strategic update, we recorded a \$2.2 million goodwill impairment charge related to our turfgrass biotechnology program. Similarly, a strategic update of certain information technology initiatives in our Scotts LawnService® segment resulted in a \$3.9 million impairment charge.

Our annual impairment review in the first quarter of fiscal 2006 resulted in an impairment charge of \$1.0 million associated with a tradename no longer in use in our U.K. consumer business. Category declines in the European consumer markets during the 2006 season resulted in a decline in the profitability of the consumer component of our International business segment in fiscal 2006. As such, we undertook an interim impairment test for this business in the fourth quarter of fiscal 2006. After an evaluation, management reached the conclusion that the projections supporting fiscal 2006 first quarter impairment testing for the consumer component of our International business segment were unlikely to be met. As a result of this evaluation, we recorded a \$65.4 million non-cash impairment charge, \$62.3 million of which was associated with indefinite-lived tradenames that continue to be employed in the consumer portion of our International segment. The balance of the fiscal 2006 fourth quarter impairment charge was in our North America segment and consisted of \$1.3 million for a Canadian tradename being phased out and \$1.8 million related to goodwill of a pottery business we exited.

Other charges in fiscal 2007 relate to certain assets and ongoing monitoring and remediation costs associated with our turfgrass biotechnology program. Restructuring activities in fiscal 2006 and fiscal 2005 related primarily to organizational reductions associated with Project Excellence initiated in the third quarter of fiscal 2005. As a result of this program, approximately 110 associates accepted early retirement or were severed during the last four months of fiscal 2005. Approximately 110 additional associates exited in fiscal 2006.

#### **Other Income, net**

Other income, net was \$11.5 million for fiscal 2007, \$9.2 million for fiscal 2006, and \$7.5 million for fiscal 2005. Royalty income amounted to \$9.9 million in fiscal 2007 and \$6.8 million in fiscal 2006. Other income in fiscal 2005 included a \$4.1 million gain from a legal judgment.

#### **Income from Operations**

Income from operations in fiscal 2007 was \$277.1 million compared to \$252.5 million in fiscal 2006, an increase of \$24.6 million. Both years were negatively impacted by impairment, restructuring and other charges that, if excluded, results in a decline of \$13.1 million of income from operations in fiscal 2007 as compared to fiscal 2006. The adverse effects of weather on net sales growth coupled with a 40 basis point decline in gross profit and SG&A spending increases were the drivers behind this decline.

Income from operations in fiscal 2006 increased \$51.6 million from fiscal 2005. Income from operations in fiscal 2006 was negatively impacted by \$66.4 million from impairment charges and an additional \$9.4 million of restructuring charges. Income from operations in fiscal 2005 was negatively impacted by the following charges: (1) \$45.7 million related to the Roundup® deferred contribution charge; (2) a \$22.0 million charge for impairment of U.K. intangibles; and (3) \$26.3 million in restructuring charges. These were partially offset by \$16.8 million of litigation related income. If these unusual factors were excluded from the year-over-year comparison, fiscal 2006 would show an 18% improvement over fiscal 2005. Higher net sales and Project Excellence savings, offset by a gross

margin rate decline and growth in advertising spending, were the major contributors to the adjusted 18% growth in income from operations.

### **Interest Expense and Refinancing Activities**

Interest expense in fiscal 2007 was \$70.7 million compared to \$39.6 in fiscal 2006. This increase in interest expense was attributable to an increase in borrowings resulting from the recapitalization transactions that were consummated during the second quarter of fiscal 2007, coupled with an increase

in our weighted average interest rate resulting from our increased leverage and higher LIBOR rates in general. Average borrowings increased \$422.5 million, and weighted average interest rates increased by 70 basis points, in fiscal 2007 as compared to the prior fiscal year. We also recorded \$18.3 million in costs related to the refinancing undertaken to facilitate the recapitalization transactions.

### Income Taxes

The effective tax rate for fiscal 2007 was 39.7% compared to 37.7% in fiscal 2006 and 36.5% in fiscal 2005. The increase in the effective tax rate for fiscal 2007 was due to the goodwill impairment charge which is not deductible for tax purposes. The effective tax rate in fiscal 2006 was higher than fiscal 2005 due to favorable settlements in fiscal 2005 related to prior year foreign tax audits. We anticipate the effective tax rate will be in the range of 36% to 37% for fiscal 2008.

### Net Income and Earnings per Share

While income from operations increased \$24.6 million over fiscal 2006, net income decreased from \$132.7 million or \$1.91 per diluted share in fiscal 2006 to \$113.4 million or \$1.69 per diluted share in fiscal 2007. Adverse weather conditions in North America negatively impacted net sales, particularly during the important month of April. Costs related to the refinancing, increased levels of debt, and a higher weighted average interest rate resulting from the recapitalization transactions coupled with a higher effective tax rate caused the decline. Average diluted shares outstanding decreased from 69.4 million in fiscal 2006 to 67.0 million in fiscal 2007, due to the modified Dutch auction tender offer that resulted in the repurchase of 4.5 million of our common shares, weighted for the period outstanding, as part of the recapitalization transactions consummated in the second quarter of fiscal 2007.

Net income increased from \$100.6 million or \$1.47 per diluted share in fiscal 2005 to \$132.7 million or \$1.91 per diluted share in fiscal 2006. As described in the Income from Operations discussion, the benefit from net sales growth and Project Excellence savings was offset by impairment and restructuring charges in fiscal 2006, while similar factors impacted fiscal 2005 along with the Roundup® deferred contribution charge. Average diluted shares outstanding increased from 68.6 million in fiscal 2005 to 69.4 million in fiscal 2006, due to option exercises and the impact on common share equivalents of a higher average share price, partially offset by the repurchase of our common shares under a share repurchase program approved by our Board of Directors in November 2005.

### Segment Results

Our operations are divided into the following reportable segments: North America, Scotts LawnService®, International, and Corporate & Other. The Corporate & Other segment consists of Smith & Hawken® and corporate general and administrative expenses. Segment performance is evaluated based on several factors, including income from operations before amortization, and impairment, restructuring and other charges, which is a non-GAAP financial measure. Management uses this measure of operating profit to gauge segment performance because we believe this measure is the most indicative of performance trends and the overall earnings potential of each segment.

### Net Sales by Segment (in millions)

	2007	2006	2005
North America	\$ 1,988.3	\$ 1,914.5	\$ 1,668.1
Scotts LawnService®	230.5	205.7	159.8

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International	469.8	408.5	430.3
Corporate & Other	184.0	169.2	159.6
Segment total	2,872.6	2,697.9	2,417.8
Roundup® deferred contribution charge			(45.7)
Roundup® amortization	(0.8)	(0.8)	(2.8)
	\$ 2,871.8	\$ 2,697.1	\$ 2,369.3

**Income from Operations by Segment (in millions)**

	2007	2006	2005
North America	\$ 375.4	\$ 391.2	\$ 355.4
Scotts LawnService®	11.3	15.6	13.1
International	35.0	28.5	34.3
Corporate & Other	(90.5)	(91.0)	(105.7)
Segment total	331.2	344.3	297.1
Roundup® deferred contribution charge			(45.7)
Roundup® amortization	(0.8)	(0.8)	(2.8)
Amortization	(15.3)	(15.2)	(14.8)
Impairment of intangibles and goodwill	(35.3)	(66.4)	(23.4)
Restructuring and other charges	(2.7)	(9.4)	(9.5)
	\$ 277.1	\$ 252.5	\$ 200.9

**North America**

Segment net sales were \$1.99 billion in fiscal 2007, an increase of 3.9% from fiscal 2006. Excluding the impact of acquisitions, net sales improved 2.5%, approximately 1.9% of which was a result of pricing. Adverse weather conditions for much of the core selling season disproportionately impacted the lawns business, which includes both fertilizers and grass seed, resulting in a 5.6% decline in net sales. The other core businesses were less impacted by the weather, with net sales in the gardening category (growing media and plant food) up 7.4% and Ortho® up 2.9%. Net sales in our wild bird food business improved 13.5% as we began to see success from the launch of Scotts® branded bird food at Wal\*Mart, combined with significant pricing increases in the latter portion of fiscal 2007. The increase in net sales did not generate the gross margin improvement needed to offset the growth in advertising and other SG&A spending, with the result being a decline in segment operating income of \$15.8 million or 4.0%.

For fiscal 2006, segment net sales were \$1.91 billion, an increase of 14.8% from fiscal 2005. Excluding the impact of acquisitions, sales improved 7.9%, approximately 1.9% of which was a result of pricing. Each of the core businesses performed well, with lawns business up 10.5%, gardening up 16.0% benefiting from the very successful launch of Miracle-Gro® LiquaFeed®, and Ortho® net sales down 1.5% due to an unfavorable season for weed control products. The overall net sales growth and Project Excellence savings, offset by a gross margin rate decline and growth in advertising spending, led to an increase in segment operating income of \$35.8 million or 10.1%.

**Scotts LawnService®**

Segment net sales increased 12.1% to \$230.5 million for fiscal 2007. This revenue growth was primarily attributable to an 11.9% increase in average customer count. Approximately 3.6% of the revenue increase came from acquisitions completed in fiscal 2006 and fiscal 2007. The increase in sales and customer count in fiscal 2007 were lower than we expected. We believe the extended cold weather from mid-February through mid-April had a significant impact on the realized rate of growth. We further believe that relative to our core business, our service segment was more sensitive to the impact of broader economic factors on consumer spending.

Operating income for this segment decreased to \$11.3 million from \$15.6 million for fiscal 2006. The decrease in operating income was primarily attributable to higher planned SG&A spending to support higher volume and continued service improvements. Improved labor productivity helped to offset higher fertilizer and fuel costs, but revenue growth was not adequate to cover the higher levels of SG&A spending due to adverse weather conditions during the important late winter / early spring period.

For fiscal 2006, segment net sales increased \$45.9 million or 28.7%. This growth in net sales came from increased customer counts and revenue per customer, strong customer retention, pricing to cover increased input costs, modest geographic expansion and the full year impact of acquisitions. Operating income for the segment increased \$2.5 million or 19.1% in fiscal 2006. This increase was the result of

revenue growth offset by investments in personnel and infrastructure to support future growth and service levels.

We continue to expand our Scotts LawnService® business through internal growth and, to a lesser extent, acquisitions. We invested \$22.5 million of capital in lawn care acquisitions in fiscal 2007, and \$4.4 million in fiscal 2006. Acquisitions had been a major factor in the growth of the lawn care business prior to fiscal 2004. While we expect to continue making selective acquisitions in future years, we anticipate the majority of the future growth in our lawn care business will be organic.

## **International**

Net sales for the International segment in fiscal 2007 increased by 15.0% or \$61.3 million compared to fiscal 2006. Excluding the effects of currency fluctuations, net sales increased 5.5%. This segment saw improvement in every major market, with our two largest markets, France and the United Kingdom, up 11% and 2% for the fiscal year, respectively, as measured in local currencies. Our international professional business also delivered consistent growth with a 9% increase in net sales from the prior year.

Net sales for the International segment in fiscal 2006 declined by 5.1% or \$21.8 million compared to fiscal 2005. Excluding the effects of currency fluctuations, net sales declined 1.7%. The retail environment in Europe was challenging with category sales down in both the United Kingdom and France, our two largest European markets. We believe listing improvements had resulted in market share gains; however, these gains did not result in top line growth due to the category declines.

In fiscal 2007, International operating income increased \$6.5 million or 22.8% as compared to fiscal 2006. A steady gross margin on higher net sales and tight control over growth in SG&A spending contributed to the increase. Operating income decreased \$5.8 million or 16.9% in fiscal 2006, compared to fiscal 2005. Lower sales and gross margins were partially offset by reduced SG&A spending, resulting in the year-over-year decline.

## **Corporate & Other**

The loss from operations in Corporate & Other was \$90.5 million in fiscal 2007, \$91.0 million in fiscal 2006, and \$105.7 million in fiscal 2005. Spending at the Corporate level declined more than the numbers indicate for fiscal 2007, as fiscal 2006 benefited from the \$10.1 million insurance recovery. Significant reductions in legal and Sarbanes-Oxley compliance costs in fiscal 2006 served to reduce the loss as compared to fiscal 2005, although a loss in our Smith & Hawken® business mitigated the impact of these cost reductions.

## **Management's Outlook**

We were satisfied with our financial performance in fiscal 2007 in light of the challenges caused by weather and macroeconomic pressures that affected our major retail partners. Despite these issues, we reported record net sales and improvement in consumer purchases of our products as measured by point-of-sale data provided by our major retail partners. In addition, net cash provided by operating activities less capital investments amounted to an impressive \$192.6 million.

As we look to fiscal 2008, we expect that net income and earnings per share are likely to be in line with the results we reported in fiscal 2007. While we anticipate organic sales growth in our core North America segment, a moderating retail environment could result in lower growth rates in fiscal 2008 than we have reported in recent years. Additionally, the Company expects to make certain incremental strategic investments as well as report higher interest expense throughout fiscal 2008. Some of the increased spending in fiscal 2008 will be specifically focused on initiatives outlined in the Strategic Initiatives section of ITEM 1. BUSINESS, all of which are expected to increase

operating profits over the long-term.

From a financial perspective, the Company remains focused on continuing to improve its Free Cash Flow and Return on Invested Capital (ROIC), both of which the Company believes are important drivers of shareholder value. Our regular quarterly dividend will allow us to continue to return funds to shareholders while maintaining our targeted capital structure and flexibility to pursue strategic acquisition opportunities.

For certain information concerning our risk factors, see ITEM 1A. RISK FACTORS.



## Liquidity and Capital Resources

### *Operating Activities*

Although net income plus noncash impairment charges, stock-based compensation expense, depreciation and amortization declined by \$49.6 million from \$281.8 in fiscal 2006 to \$232.2 million in fiscal 2007, net cash provided from operating activities for fiscal 2007 increased by \$64.2 million over fiscal 2006. Factors that negatively impacted operating cash flow in fiscal 2006 were the utilization of \$63.9 million in cash plus \$34.3 million in accounts payable to fund an increase of \$98.2 million of accounts receivable and inventories. We undertook an inventory build in North America in the fourth quarter of fiscal 2006 to take advantage of a historical trough in urea costs and to increase the predictability of fiscal 2007 costs. Smith & Hawken® inventories also increased in fiscal 2006 as a result of a conscious early season effort to improve customer service; however, sales subsequently did not meet expectations. By comparison, there were only modest changes in outstanding amounts of accounts receivable, inventories, and accounts payable at the end of fiscal 2007 versus 2006. Fiscal 2006 also used \$43.0 million of operating cash flows to fund the Roundup® deferred contribution payment in October 2005. Lastly, fiscal 2007 operating cash flow includes the add back of \$18.3 million of financing costs related to the recapitalization that are reflected as a financing cost.

The seasonal nature of our operations generally requires cash to fund significant increases in working capital (primarily inventory) during the first half of the year. Receivables and payables also build substantially in the second quarter of the year in line with the timing of sales to support our retailers spring selling season. These balances liquidate during the June through September period as the lawn and garden season unwinds. Unlike our core retail business, Scotts LawnService® typically has its highest receivables balances in the fourth quarter because of the seasonal timing of customer applications and extra service revenues.

### *Investing Activities*

Cash used in investing activities was \$72.2 million and \$174.1 million for fiscal 2007 and fiscal 2006, respectively. Our acquisitions of Gutwein, RMC, and certain brands and assets of Landmark Seed Company and Turf-Seed in fiscal 2006 were the primary drivers behind the spending for investing activities. No such acquisitions were undertaken in fiscal 2007, with acquisition activity restricted to our Scotts LawnService® business. Capital spending was consistent at \$54.0 million in fiscal 2007 versus \$57.0 million in fiscal 2006.

### *Financing Activities*

Financing activities used cash of \$158.8 million and \$46.9 million in fiscal 2007 and fiscal 2006, respectively. Our recapitalization plan that was consummated during the second quarter of fiscal 2007 returned \$750 million to shareholders. In addition, we repurchased all of our 65/8% senior subordinated notes in an aggregate principal amount of \$200 million. These actions were financed by replacing, effective February 7, 2007, our prior revolving credit facility with new senior secured \$2.15 billion multicurrency credit facilities that provide for revolving credit and term loans through February 7, 2012.

As noted earlier, in fiscal 2006, we began a program to return cash to our shareholders. We paid dividends of \$33.5 million and repurchased \$87.9 million of our common shares financed in part by a net increase in borrowings under our prior revolving credit facility of \$55.2 million. Prior to fiscal 2006, our focus was on aggressively paying down debt and managing our borrowings to maximize the benefit of our improving capital structure and debt facilities. Proceeds from the exercise of employee stock options were \$29.2 million in fiscal 2007 compared to \$17.6 million in fiscal 2006.

### *Credit Agreements*

Our primary sources of liquidity are cash generated by operations and borrowings under our credit agreements. In connection with the recapitalization transactions discussed in Note 2 to the Consolidated Financial Statements included in this Annual Report on Form 10-K, Scotts Miracle-Gro and certain of its subsidiaries entered into the following loan facilities totaling up to \$2.15 billion in the aggregate: (a) a senior secured five-year term loan in the principal amount of \$560 million and (b) a senior secured five-year revolving loan facility in the aggregate principal amount of up to \$1.59 billion. Borrowings may be made in various currencies including U.S. dollars, Euros, British pounds sterling, Australian dollars and Canadian dollars. The new \$2.15 billion senior secured credit facilities replaced the Company's former

\$1.05 billion senior credit facility. In addition, we used proceeds from the new senior secured credit facilities to repurchase all of our then outstanding 65/8% senior subordinated notes in an aggregate principal amount of \$200 million. Under our current structure, we may request an additional \$200 million in revolving credit and/or term credit commitments, subject to approval from our lenders. As of September 30, 2007, there was \$1,098.1 million of availability under our new senior secured credit facilities. Note 10 to the Consolidated Financial Statements included in this Annual Report on Form 10-K provides additional information pertaining to our borrowing arrangements. We were in compliance with all of our debt covenants throughout fiscal 2007.

In April of fiscal 2007, we entered into a Master Accounts Receivable Purchase Agreement (the MARP Agreement) with a stated termination date of April 10, 2008, as permitted under our senior secured credit facilities. The MARP Agreement was entered into as it provides an interest rate savings as compared to borrowing under our new senior secured credit facilities. The MARP Agreement provides for the discounted sale, on a revolving basis, of accounts receivable generated by specified account debtors, with seasonally adjusted monthly aggregate limits ranging from \$55 million to \$300 million. The MARP Agreement also provides for specified account debtor sublimit amounts, which provide limits on the amount of receivables owed by individual account debtors that can be sold. The Company accounts for the sale of receivables under the MARP Agreement as short-term debt and continues to carry the receivables on its Consolidated Balance Sheet, in accordance with SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Sales under the MARP Agreement at September 30, 2007 were \$64.4 million.

At September 30, 2007, the Company had outstanding interest rate swaps with major financial institutions that effectively converted a portion of our variable-rate debt denominated in the Euro, British pound and U.S. dollar to a fixed rate. The swap agreements have a total U.S. dollar equivalent notional amount of \$720.0 million. The terms, expiration dates and rates of these swaps are shown in the table below.

Currency	Notional Amount in USD	Term	Expiration Date	Fixed Rate
British pound	\$ 59.0	3 years	11/17/2008	4.76%
Euro	61.0	3 years	11/17/2008	2.98%
U.S. dollar	200.0	2 years	3/31/2009	4.90%
U.S. dollar	200.0	3 years	3/31/2010	4.87%
U.S. dollar	200.0	5 years	2/14/2012	5.20%

Our primary sources of liquidity are cash generated by operations and borrowings under our credit facilities. We believe our credit facilities will continue to provide the Company with the capacity to pursue targeted, strategic acquisitions that leverage our core competencies.

#### *Judicial and Administrative Proceedings*

We are party to various pending judicial and administrative proceedings arising in the ordinary course of business. These include, among others, proceedings based on accidents or product liability claims and alleged violations of environmental laws. We have reviewed our pending environmental and legal proceedings, including the probable outcomes, reasonably anticipated costs and expenses, reviewed the availability and limits of our insurance coverage and have established what we believe to be appropriate reserves. We do not believe that any liabilities that may result from these proceedings are reasonably likely to have a material adverse effect on our liquidity, financial condition or

results of operations; however, there can be no assurance that future quarterly or annual operating results will not be materially affected by final resolution of these matters.

*Contractual Obligations and off-Balance Sheet Arrangements*

The following table summarizes our future cash outflows for contractual obligations as of September 30, 2007 (in millions):

Contractual Cash Obligations	Total	Payments Due by Period			
		Less than 1 year	1-3 years	4-5 years	More than 5 years
Long-term debt obligations	\$ 1,117.8	\$ 86.4	\$ 244.4	\$ 783.0	\$ 4.0
Operating lease obligations	194.2	37.5	58.3	43.0	55.4
Purchase obligations	569.2	292.0	211.6	58.1	7.5
Other, primarily retirement plan obligations	50.7	16.8	7.5	7.8	18.6
Total contractual cash obligations	\$ 1,931.9	\$ 432.7	\$ 521.8	\$ 891.9	\$ 85.5

Purchase obligations primarily represent outstanding purchase orders for materials used in the Company's manufacturing processes. Purchase obligations also include commitments for warehouse services, seed, and out-sourced information services which comprise the unconditional purchase obligations disclosed in Note 16 to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

Other includes actuarially determined retiree benefit payments and pension funding to comply with local funding requirements. Pension funding requirements beyond fiscal 2008 are not currently determinable. The above table excludes interest payments, and insurance accruals as the Company is unable to estimate the timing of the payment for these items.

The Company has no off-balance sheet financing arrangements.

In our opinion, cash flows from operations and capital resources will be sufficient to meet debt service and working capital needs during fiscal 2008, and thereafter for the foreseeable future. However, we cannot ensure that our business will generate sufficient cash flow from operations or that future borrowings will be available under our credit facilities in amounts sufficient to pay indebtedness or fund other liquidity needs. Actual results of operations will depend on numerous factors, many of which are beyond our control.

**Environmental Matters**

We are subject to local, state, federal and foreign environmental protection laws and regulations with respect to our business operations and believe we are operating in substantial compliance with, or taking actions aimed at ensuring compliance with, such laws and regulations. We are involved in several legal actions with various governmental agencies related to environmental matters. While it is difficult to quantify the potential financial impact of actions involving environmental matters, particularly remediation costs at waste disposal sites and future capital expenditures for environmental control equipment, in the opinion of management, the ultimate liability arising from such environmental matters, taking into account established reserves, should not have a material adverse effect on our financial position, results of operations or cash flows. However, there can be no assurance that the resolution of these

matters will not materially affect our future quarterly or annual results of operations, financial condition or cash flows. Additional information on environmental matters affecting us is provided in ITEM 1. BUSINESS Environmental and Regulatory Considerations, ITEM 1. BUSINESS Regulatory Actions and ITEM 3. LEGAL PROCEEDINGS of this Annual Report on Form 10-K.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of financial condition and results of operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Certain accounting policies are particularly significant, including those related to revenue recognition, goodwill and intangibles, certain employee benefits, and income taxes. We believe these accounting policies, and others set forth in Note 1 to the Consolidated Financial Statements included in this Annual Report on Form 10-K, should be reviewed as they are integral to understanding our results of operations and financial position. Our critical accounting policies are reviewed periodically with the Audit Committee of our Board of Directors.

The preparation of financial statements requires management to use judgment and make estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to customer programs and incentives, product returns, bad debts, inventories, intangible assets, income taxes, restructuring, environmental matters, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Although actual results historically have not deviated significantly from those determined using our estimates, our results of operations or financial position could differ, perhaps materially, from these estimates under different assumptions or conditions.

### **Revenue Recognition and Promotional Allowances**

Most of our revenue is derived from the sale of inventory, and we recognize revenue when title and risk of loss transfer, generally when products are received by the customer. Provisions for payment discounts, product returns and allowances are recorded as a reduction of sales at the time revenue is recognized based on historical trends and adjusted periodically as circumstances warrant. Similarly, reserves for uncollectible receivables due from customers are established based on management's judgment as to the ultimate collectibility of these balances. We offer sales incentives through various programs, consisting principally of volume rebates, cooperative advertising, consumer coupons and other trade programs. The cost of these programs is recorded as a reduction of sales. The recognition of revenues, receivables and trade programs requires the use of estimates. While we believe these estimates to be reasonable based on the then current facts and circumstances, there can be no assurance that actual amounts realized will not differ materially from estimated amounts recorded.

### **Long-lived Assets, including Property, Plant and Equipment**

Property, plant, and equipment are stated at cost. Depreciation of property, plant, and equipment is provided on the straight-line method and is based on the estimated useful economic lives of the assets. Intangible assets with finite lives, and therefore subject to amortization, include technology (e.g. patents), customer relationships and certain tradenames. These intangible assets are being amortized on the straight-line method over periods typically ranging from 10 to 25 years. The Company reviews long-lived assets whenever circumstances change such that the indicated recorded value of an asset may not be recoverable.

### **Goodwill and Indefinite-lived Intangible Assets**

We have significant investments in intangible assets and goodwill. Whenever changing conditions warrant, we review the assets that may be affected for realization. At least annually, we review goodwill and indefinite-lived intangible assets for impairment. As discussed in the *Results of Operations* section of this MD&A, during the third quarter of fiscal 2007, the Company changed the timing of its annual goodwill impairment testing from the last day of our fiscal first quarter to the first day of our fiscal fourth quarter. The review for impairment of intangibles and goodwill is primarily based on our estimates of discounted future cash flows, which are based upon budgets and longer-range strategic plans. These budgets and plans are used for internal purposes and are also the basis for communication with outside parties about future business trends. While we believe the assumptions we use to estimate future cash flows are reasonable, there can be no assurance that the expected future cash flows will be realized. As a result, impairment charges that possibly should have been recognized in earlier periods may not be recognized until later periods if actual results deviate unfavorably from earlier estimates. An asset's value is deemed impaired if the discounted cash flows or earnings projections generated do not substantiate the carrying value of the asset. The estimation of such amounts requires management judgment with respect to revenue and expense growth rates, changes in working capital and selection of an appropriate discount rate, as applicable. The use of different assumptions would increase or decrease discounted future operating cash flows or earnings projections and could, therefore, change impairment determinations.

Related to our annual impairment review of indefinite-lived trade names and goodwill, fair values were determined using discounted cash flow models involving several assumptions. Changes in our assumptions could materially impact our fair value estimates. Assumptions critical to our fair value estimates were: (i) present value factors used in determining the fair value of the reporting units and trade names; (ii) royalty rates used in our trade name valuations; (iii) projected average revenue growth rates used in the reporting unit and trade name models; and (iv) projected long-term growth rates used in the derivation of terminal year values. These and other assumptions are impacted by economic



conditions and expectations of management and will change in the future based on period specific facts and circumstances.

### **Inventories**

Inventories are stated at the lower of cost or market, the majority of which are based on the first-in, first-out method of accounting. Reserves for excess and obsolete inventory are based on a variety of factors, including product changes and improvements, changes in active ingredient availability and regulatory acceptance, new product introductions and estimated future demand. The adequacy of our reserves could be materially affected by changes in the demand for our products or regulatory actions.

### **Contingencies**

As described more fully in Note 17 to the Consolidated Financial Statements included in this Annual Report on Form 10-K, we are involved in significant environmental and legal matters, which have a high degree of uncertainty associated with them. We continually assess the likely outcomes of these matters and the adequacy of amounts, if any, provided for their resolution. There can be no assurance that the ultimate outcomes will not differ materially from our assessment of them. There can also be no assurance that all matters that may be brought against us are known at any point in time.

### **Income Taxes**

Our annual effective tax rate is established based on our income, statutory tax rates and the tax impacts of items treated differently for tax purposes than for financial reporting purposes. We record income tax liabilities utilizing known obligations and estimates of potential obligations. A deferred tax asset or liability is recognized whenever there are future tax effects from existing temporary differences and operating loss and tax credit carryforwards. Valuation allowances are used to reduce deferred tax assets to the balance that is more likely than not to be realized. We must make estimates and judgments on future taxable income, considering feasible tax planning strategies and taking into account existing facts and circumstances, to determine the proper valuation allowance. When we determine that deferred tax assets could be realized in greater or lesser amounts than recorded, the asset balance and consolidated statement of operations reflect the change in the period such determination is made. Due to changes in facts and circumstances and the estimates and judgments that are involved in determining the proper valuation allowance, differences between actual future events and prior estimates and judgments could result in adjustments to this valuation allowance. We use an estimate of our annual effective tax rate at each interim period based on the facts and circumstances available at that time, while the actual effective tax rate is calculated at year-end.

### **Associate Benefits**

We sponsor various post-employment benefit plans. These include pension plans, both defined contribution plans and defined benefit plans, and other post-employment benefit (OPEB) plans, consisting primarily of health care for retirees. For accounting purposes, the defined benefit pension and OPEB plans are dependent on a variety of assumptions to estimate the projected and accumulated benefit obligations determined by actuarial valuations. These assumptions include the following: discount rate; expected salary increases; certain employee-related factors, such as turnover, retirement age and mortality; expected return on plan assets; and health care cost trend rates. These and other assumptions affect the annual expense recognized for these plans.

Assumptions are reviewed annually for appropriateness and updated as necessary. We base the discount rate assumption on investment yields available at year-end on corporate long-term bonds rated AA or the equivalent. The salary growth assumption reflects our long-term actual experience, the near-term outlook and assumed inflation. The

expected return on plan assets assumption reflects asset allocation, investment strategy and the views of investment managers regarding the market. Retirement and mortality rates are based primarily on actual and expected plan experience. The effects of actual results differing from our assumptions are accumulated and amortized over future periods.

Changes in the discount rate and investment returns can have a significant effect on the funded status of our pension plans and shareholders' equity. We cannot predict these discount rates or investment returns with certainty and, therefore, cannot determine whether adjustments to our shareholders' equity for minimum pension liability in subsequent years will be significant.

## Accruals for Self-Insurance

We maintain insurance for certain risks, including workers' compensation, general liability and vehicle liability, and are self-insured for employee-related health care benefits. We establish reserves for losses based on our claims experience and industry actuarial estimates of the ultimate loss amount inherent in the claims, including losses for claims incurred but not reported. Our estimate of self-insured liabilities is subject to change as new events or circumstances develop which might materially impact the ultimate cost to settle these losses.

## Other Significant Accounting Policies

Other significant accounting policies, primarily those with lower levels of uncertainty than those discussed above, are also critical to understanding the consolidated financial statements. The Notes to the Consolidated Financial Statements included in this Annual Report on Form 10-K contain additional information related to our accounting policies, including recent accounting pronouncements, and should be read in conjunction with this discussion.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As part of our ongoing business, we are exposed to certain market risks, including fluctuations in interest rates, foreign currency exchange rates and commodity prices. Financial derivative and other instruments are used to manage these risks. These instruments are not used for speculative purposes.

### Interest Rate Risk

The Company had variable-rate debt instruments outstanding at September 30, 2007 and 2006 that are impacted by changes in interest rates. As a means of managing our interest rate risk on these debt instruments, the Company enters into interest rate swap agreements to effectively convert certain variable-rate debt obligations to fixed rates.

At September 30, 2007, the Company had outstanding interest rate swaps with major financial institutions that effectively convert a portion of our variable-rate debt to a fixed rate. The swap agreements had a total U.S. dollar equivalent notional amount of \$720.0 million. At September 30, 2006, the Company had outstanding interest rate swaps with major financial institutions that effectively converted a portion of our British pound (GBP) and Euro denominated variable-rate debt to a fixed rate. The swap agreements have a total U.S. dollar equivalent notional amount of \$120.0 million with three-year terms expiring November 2008. Under the terms of these swaps, we paid fixed rates of 2.98% on Euro denominated swaps and 4.76% on GBP denominated swaps.

The following table summarizes information about our derivative financial instruments and debt instruments that are sensitive to changes in interest rates as of September 30, 2007 and 2006. For debt instruments, the table presents principal cash flows and related weighted-average interest rates by expected maturity dates. For interest rate swaps, the table presents expected cash flows based on notional amounts and weighted-average interest rates by contractual maturity dates. Weighted-average variable rates are based on implied forward rates in the yield curve at September 30, 2007 and 2006. A change in our variable interest rate of 1% would have a \$4.3 million impact on interest expense assuming the \$434.0 million of our variable-rate debt that had not been hedged via an interest rate swap at September 30, 2007 was outstanding for the entire fiscal year. The information is presented in U.S. dollars (in millions):

2007	2008	Expected Maturity Date				After	Total	Fair Value
		2009	2010	2011				

Long-term debt:

Variable rate debt	\$ 82.6	\$ 84.0	\$ 154.0	\$ 193.2	\$ 578.4	\$ 1,092.2	\$ 1,092.2
Average rate	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	
Interest rate derivatives:							
Interest rate swaps							
based on U.S. Dollar,							
Euro and GBP LIBOR	\$ 1.9	\$ (0.9)	\$ (1.4)	\$	\$ (3.7)	\$ (4.1)	\$ (4.1)
Average rate	3.87%	4.90%	4.87%		5.20%	4.71%	

2006	Expected Maturity Date			Total	Fair Value
	2008	2010	After		
Long-term debt:					
Fixed rate debt		\$	\$ 200.0	\$ 200.0	\$ 194.0
Average rate			6.625%	6.625%	
Variable rate debt		\$ 253.8	\$	\$ 253.8	\$ 253.8
Average rate		4.4%		4.4%	
Interest rate derivatives:					
Interest rate swaps based on Euro and GBP					
LIBOR	\$ 1.3	\$	\$	\$ 1.3	\$ 1.3
Average rate	3.87%			3.87%	

Excluded from the information provided above are \$25.6 million and \$27.4 million at September 30, 2007 and 2006, respectively, of miscellaneous debt instruments.

### Other Market Risks

Our market risk associated with foreign currency rates is not considered to be material. Through fiscal 2007, we had only minor amounts of transactions that were denominated in currencies other than the currency of the country of origin. We use foreign currency swap contracts to manage the exchange rate risk associated with intercompany loans with foreign subsidiaries that are denominated in U.S. dollars. At September 30, 2007, the notional amount of outstanding contracts was \$101.5 million with a fair value of \$(1.3) million. At September 30, 2006, the notional amount of outstanding contracts was \$66.7 million with a fair value of \$0.4 million. We are subject to market risk from fluctuating market prices of certain raw materials, including urea, resins, grass seed, and wild bird food components. Our objectives surrounding the procurement of these materials are to ensure continuous supply and to minimize costs. We seek to achieve these objectives through negotiation of contracts with favorable terms directly with vendors. In addition, we have entered into arrangements to partially mitigate the effect of fluctuating direct and indirect fuel costs on our North America and Scotts LawnService® businesses and hedged a portion of our urea needs for fiscal 2008. We had outstanding a strip of collars for approximately 0.5 million and 3.2 million gallons of fuel with fair values of \$0 and \$0.2 million at September 30, 2007 and 2006, respectively. We also had hedging arrangements for 45,000 and 69,000 aggregate tons of urea at September 30, 2007 and 2006, respectively. The fair value of the 45,000 aggregate tons at September 30, 2007 was \$1.0 million, while the fair value of the 69,000 aggregate tons at September 30, 2006 was \$0.

### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The financial statements and other information required by this Item are contained in the consolidated financial statements, notes thereto and schedule listed in the Index to Consolidated Financial Statements and Financial Statement Schedule on page 53 of this Annual Report on Form 10-K herein.

### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None

### **ITEM 9A. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

With the participation of the principal executive officer and the principal financial officer of The Scotts Miracle-Gro Company (the Registrant), the Registrant's management has evaluated the effectiveness of the Registrant's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)), as of the end of the fiscal year covered by this

Annual Report on Form 10-K. Based upon that evaluation, the Registrant's principal executive officer and principal financial officer have concluded that:

information required to be disclosed by the Registrant in this Annual Report on Form 10-K and the other reports that the Registrant files or submits under the Exchange Act would be accumulated and communicated to the Registrant's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure;

information required to be disclosed by the Registrant in this Annual Report on Form 10-K and the other reports that the Registrant files or submits under the Exchange Act would be recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and

the Registrant's disclosure controls and procedures were effective as of the end of the fiscal year covered by this Annual Report on Form 10-K.

### **Management's Annual Report on Internal Control Over Financial Reporting**

The Annual Report of Management on Internal Control Over Financial Reporting required by Item 308(a) of SEC Regulation S-K is included on page 54 of this Annual Report on Form 10-K.

### **Attestation Report of Independent Registered Public Accounting Firm**

The Report of Independent Registered Public Accounting Firm required by Item 308(b) of SEC Regulation S-K is included on page 56 of this Annual Report on Form 10-K.

### **Changes in Internal Control Over Financial Reporting**

There were no changes in the Registrant's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the Registrant's fiscal quarter ended September 30, 2007, that have materially affected, or are reasonably likely to materially affect, the Registrant's internal control over financial reporting.

### **ITEM 9B. OTHER INFORMATION**

None.

### **PART III**

#### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

##### **Directors, Executive Officers and Persons Nominated or Chosen to Become Directors or Executive Officers**

The information required by Item 401 of SEC Regulation S-K concerning the directors of The Scotts Miracle-Gro Company ( Scotts Miracle-Gro or the Registrant ) and the nominees for re-election as directors of Scotts Miracle-Gro at the Annual Meeting of Shareholders to be held on January 31, 2008 (the 2008 Annual Meeting ) is incorporated herein by reference from the disclosure which will be included under the caption ELECTION OF DIRECTORS in Scotts Miracle-Gro's definitive Proxy Statement relating to the 2008 Annual Meeting ( Scotts Miracle-Gro's Definitive Proxy Statement ), which will be filed pursuant to SEC Regulation 14A not later than 120 days after the end of Scotts Miracle-Gro's fiscal year ended September 30, 2007.

The information required by Item 401 of SEC Regulation S-K concerning the executive officers of Scotts Miracle-Gro is incorporated herein by reference from the disclosure included under the caption SUPPLEMENTAL ITEM. EXECUTIVE OFFICERS OF THE REGISTRANT in Part I of the Annual Report on Form 10-K.

##### **Compliance with Section 16(a) of the Securities Exchange Act of 1934**

The information required by Item 405 of SEC Regulation S-K is incorporated herein by reference from the disclosure which will be included under the caption SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE in Scotts Miracle-Gro's Definitive Proxy Statement.

##### **Procedures for Recommending Director Nominees**

The information required by Item 407(c)(3) of SEC Regulation S-K is incorporated herein by reference from the disclosure to be included under the captions CORPORATE GOVERNANCE Nominations of Directors and MEETINGS AND COMMITTEES OF THE BOARD Committees of the Board Governance and Nominating Committee in Scotts Miracle-Gro's Definitive Proxy Statement.

##### **Audit Committee**

The information required by Items 407(d)(4) and 407(d)(5) of SEC Regulation S-K is incorporated herein by reference from the disclosure to be included under the caption MEETINGS AND COMMITTEES OF THE BOARD Committees of the Board Audit Committee in Scotts Miracle-Gro's Definitive Proxy Statement.

##### **Committee Charters; Code of Business Conduct and Ethics; Corporate Governance Guidelines**

The Board of Directors of the Registrant has adopted charters for each of the Audit Committee, the Governance and Nominating Committee, the Compensation and Organization Committee, the Finance Committee and the Innovation & Technology Committee.

In accordance with the requirements of Section 303A.10 of the New York Stock Exchange's Listed Company Manual, the Board of Directors of the Registrant has adopted a Code of Business Conduct and Ethics covering the members of the Registrant's Board of Directors and associates (employees) of the Registrant and its subsidiaries, including, without limitation, the Registrant's principal executive officer, principal financial officer and principal accounting officer. The Registrant intends to disclose the following events, if they occur, on its Internet website located at <http://investor.scotts.com> within four business days following their occurrence: (A) the date and nature of any



amendment to a provision of Scotts Miracle-Gro's Code of Business Conduct and Ethics that (i) applies to the Registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, (ii) relates to any element of the code of ethics definition enumerated in Item 406(b) of SEC Regulation S-K, and (iii) is not a technical, administrative or other non-substantive amendment; and (B) a description (including the nature of the waiver, the name of the person to whom the waiver was granted and the date of the waiver) of any waiver, including an implicit waiver, from a provision of the Code of Business Conduct and Ethics to the Registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar

functions, that relates to one or more of the elements of the code of ethics definition set forth in Item 406(b) of SEC Regulation S-K.

The text of the Code of Business Conduct and Ethics, the Registrant's Corporate Governance Guidelines, the Audit Committee charter, the Governance and Nominating Committee charter, the Compensation and Organization Committee charter, the Finance Committee charter and the Innovation & Technology Committee charter are posted under the governance link on the Registrant's Internet website located at <http://investor.scotts.com>. Interested persons may also obtain copies of each of these documents without charge by writing to The Scotts Miracle-Gro Company, Attention: Corporate Secretary, 14111 Scottslawn Road, Marysville, Ohio 43041. In addition, a copy of the Code of Business Conduct and Ethics, as amended on November 2, 2006, is incorporated by reference in Exhibit 14 to this Annual Report on Form 10-K.

#### **ITEM 11. EXECUTIVE COMPENSATION**

The information required by Item 402 of SEC Regulation S-K is incorporated herein by reference from the disclosure which will be included under the captions EXECUTIVE COMPENSATION and NON-EMPLOYEE DIRECTOR COMPENSATION in Scotts Miracle-Gro's Definitive Proxy Statement.

The information required by Item 407(e)(4) of SEC Regulation S-K is incorporated herein by reference from the disclosure which will be included under the caption MEETINGS AND COMMITTEES OF THE BOARD Committees of the Board Compensation and Organization Committee Interlocks and Insider Participation in Scotts Miracle-Gro's Definitive Proxy Statement.

The information required by Item 407(e)(5) of SEC Regulation S-K is incorporated herein by reference from the disclosure which will be included under the caption COMPENSATION AND ORGANIZATION COMMITTEE REPORT in Scotts Miracle-Gro's Definitive Proxy Statement.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

##### **Ownership of Common Shares of Scotts Miracle-Gro**

The information required by Item 403 of SEC Regulation S-K is incorporated herein by reference from the disclosure which will be included under the caption BENEFICIAL OWNERSHIP OF SECURITIES OF THE COMPANY in Scotts Miracle-Gro's Definitive Proxy Statement.

##### **Equity Compensation Plan Information**

The information required by Item 201(d) of SEC Regulation S-K is incorporated herein by reference from the disclosure which will be included under the caption EQUITY COMPENSATION PLAN INFORMATION in Scotts Miracle-Gro's Definitive Proxy Statement.

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

##### **Certain Relationships and Related Person Transactions**

The information required by Item 404 of SEC Regulation S-K is incorporated herein by reference from the disclosure which will be included under the captions ELECTION OF DIRECTORS, BENEFICIAL OWNERSHIP OF

SECURITIES OF THE COMPANY and CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS in  
Scotts Miracle-Gro's Definitive Proxy Statement.

### **Director Independence**

The information required by Item 407(a) of SEC Regulation S-K is incorporated herein by reference from the disclosure which will be included under the captions CORPORATE GOVERNANCE Director Independence and CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS in Scotts Miracle-Gro's Definitive Proxy Statement.

### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this Item 14 is incorporated herein by reference from the disclosure which will be included under the captions AUDIT COMMITTEE MATTERS Fees of the Independent

Registered Public Accounting Firm and AUDIT COMMITTEE MATTERS Pre-Approval of Services Performed by the Independent Registered Public Accounting Firm in Scotts Miracle-Gro's Definitive Proxy Statement.

## **PART IV**

### **ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

#### **(a) LIST OF DOCUMENTS FILED AS PART OF THIS REPORT**

1 and 2. Financial Statements and Financial Statement Schedule:

The response to this portion of Item 15 is submitted as a separate section of this Annual Report on Form 10-K. Reference is made to the Index to Consolidated Financial Statements and Financial Statement Schedule on page 53 herein.

3. Exhibits:

The exhibits listed on the Index to Exhibits beginning on page 102 of this Annual Report on Form 10-K are filed with this Annual Report on Form 10-K or incorporated herein by reference as noted in the Index to Exhibits. The following table provides certain information concerning each management contract or compensatory plan or arrangement required to be filed as an exhibit to this Annual Report on Form 10-K or incorporated herein by reference.

**MANAGEMENT CONTRACTS AND COMPENSATORY PLANS AND ARRANGEMENTS**

Exhibit No.	Description	Location
10(a)(1)	The O.M. Scott & Sons Company Excess Benefit Plan, effective October 1, 1993	Incorporated herein by reference to the Annual Report on Form 10-K for the fiscal year ended September 30, 1993 of The Scotts Company, a Delaware corporation (File No. 0-19768) [Exhibit 10(h)]
10(a)(2)	First Amendment to The O.M. Scott & Sons Company Excess Benefit Plan, effective as of January 1, 1998	Incorporated herein by reference to the Annual Report on Form 10-K for the fiscal year ended September 30, 2001 of The Scotts Company, an Ohio corporation ( Scotts ) (File No. 1-13292) [Exhibit 10(a)(2)]
10(a)(3)	Second Amendment to The O.M. Scott & Sons Company Excess Benefit Plan, effective as of January 1, 1999	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 2001 (File No. 1-13292) [Exhibit 10(a)(3)]
10(a)(4)	Third Amendment to The O.M. Scott & Sons Company Excess Benefit Plan, effective as of March 18, 2005 (amended title of plan to be The Scotts Company LLC Excess Benefit Plan)	Incorporated herein by reference to the Quarterly Report on Form 10-Q for the quarterly period ended April 2, 2005 of The Scotts Miracle-Gro Company (the Registrant ) (File No. 1-13292) [Exhibit 10(CC)]
10(b)(1)	The Scotts Company LLC Executive/Management Incentive Plan (as approved by the shareholders of The Scotts Miracle-Gro Company on January 26, 2006)	Incorporated herein by reference to the Registrant s Current Report on Form 8-K filed February 2, 2006 (File No. 1-13292) [Exhibit 10.4]
10(b)(2)	The Scotts Company LLC Amended and Restated Executive/Management Incentive Plan (effective as of November 7, 2007)	*
10(c)(1)	Specimen form of Employee Confidentiality, Noncompetition, Nonsolicitation Agreement for employees participating in The Scotts Company LLC Executive/Management Incentive Plan (now known as The Scotts Company LLC Amended and Restated Executive/Management Incentive Plan)	Incorporated herein by reference to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended July 1, 2006 (File No. 1-13292) [Exhibit 10.1]
10(c)(2)	Executive Officers of The Scotts Miracle-Gro Company who are parties to form of Employee Confidentiality, Noncompetition, Nonsolicitation Agreement for employees participating in The Scotts Company LLC Executive/Management Incentive Plan (now known as The Scotts Company LLC Amended and	*

Restated Executive/Management Incentive Plan)

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Exhibit No.	Description	Location
10(d)(1)	The Scotts Company 1996 Stock Option Plan (as amended through May 15, 2000)	Incorporated herein by reference to Scotts Quarterly Report on Form 10-Q for the quarterly period ended April 1, 2000 (File No. 1-13292) [Exhibit 10(d)]
10(d)(2)	The Scotts Company 1996 Stock Option Plan (2002 Amendment)	Incorporated herein by reference to Scotts Quarterly Report on Form 10-Q for the quarterly period ended December 28, 2002 (File No. 1-13292) [Exhibit 10(d)(i)]
10(d)(3)	Amendment to The Scotts Company 1996 Stock Option Plan 2005 Amendment, effective as of March 18, 2005 (amended title of plan to be The Scotts Miracle-Gro Company 1996 Stock Option Plan)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended April 2, 2005 (File No. 1-13292) [Exhibit 10(z)]
10(d)(4)	The Scotts Miracle-Gro Company Amended and Restated 1996 Stock Option Plan (effective as of October 30, 2007)	*
10(e)	Form of 1996 Stock Option Plan Stock Option Agreement Non-Qualified Stock Option	Incorporated herein by reference to Scotts Current Report on Form 8-K filed November 19, 2004 (File No. 1-13292) [Exhibit 10.7]
10(f)	Specimen form of Stock Option Agreement (as amended through October 23, 2001) for Non-Qualified Stock Options granted to employees under The Scotts Company 1996 Stock Option Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 1996 Stock Option Plan), French specimen	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 2001 (File No. 1-13292) [Exhibit 10(f)]
10(g)(1)	The Scotts Company Executive Retirement Plan	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 1998 (File No. 1-11593) [Exhibit 10(j)]
10(g)(2)	First Amendment to The Scotts Company Executive Retirement Plan, effective as of January 1, 1999	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 2001 (File No. 1-13292) [Exhibit 10(g)(2)]
10(g)(3)	Second Amendment to The Scotts Company Executive Retirement Plan, effective as of January 1, 2000	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 2001 (File No. 1-13292) [Exhibit 10(g)(3)]
10(g)(4)	Third Amendment to The Scotts Company Executive Retirement Plan, effective as of January 1, 2003	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended





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Exhibit No.	Description	Location
10(g)(5)	Fourth Amendment to The Scotts Company Executive Retirement Plan, effective as of January 1, 2004	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 2004 (File No. 1-13292) [Exhibit 10(g)(5)]
10(g)(6)	Fifth Amendment to The Scotts Company Executive Retirement Plan, effective as of March 18, 2005 (amended title of plan to be The Scotts Company LLC Executive Retirement Plan)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended April 2, 2005 (File No. 1-13292) [Exhibit 10(DD)]
10(h)	Employment Agreement, dated as of May 19, 1995, between The Scotts Company and James Hagedorn	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 1995 (File No. 1-11593) [Exhibit 10(p)]
10(i)(1)	Letter agreement, dated June 8, 2000, between The Scotts Company and Patrick J. Norton	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 2000 (File No. 1-13292) [Exhibit 10(q)]
10(i)(2)	Letter agreement, dated November 5, 2002, and accepted by Mr. Norton on November 22, 2002, pertaining to the terms of employment of Patrick J. Norton through December 31, 2005, and superseding certain provisions of the letter agreement, dated June 8, 2000, between The Scotts Company and Mr. Norton	Incorporated herein by reference to Scotts Annual Report on Form 10-K for the fiscal year ended September 30, 2002 (File No. 1-13292) [Exhibit 10(q)]
10(i)(3)	Letter of Extension, dated October 25, 2005, between The Scotts Miracle-Gro Company and Patrick J. Norton	Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed December 14, 2005 (File No. 1-13292) [Exhibit 10.3]
10(j)(1)	The Scotts Company 2003 Stock Option and Incentive Equity Plan (as approved by shareholders of The Scotts Company on January 30, 2003)	Incorporated herein by reference to Scotts Quarterly Report on Form 10-Q for the quarterly period ended December 28, 2002 (File No. 1-13292) [Exhibit 10(w)]
10(j)(2)	First Amendment to The Scotts Company 2003 Stock Option and Incentive Equity Plan, effective as of March 18, 2005 (amended title of plan to be The Scotts Miracle-Gro Company 2003 Stock Option and Incentive Equity Plan)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended April 2, 2005 (File No. 1-13292) [Exhibit 10(AA)]
10(j)(3)	The Scotts Miracle-Gro Company Amended and Restated 2003 Stock Option and Incentive Equity Plan (effective as of October 30, 2007)	*



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Exhibit No.	Description	Location
10(k)(1)	Specimen form of Award Agreement for Nondirectors used to evidence Incentive Stock Options, Nonqualified Stock Options, Stock Appreciation Rights, Restricted Stock and Performance Shares which may be granted under The Scotts-Miracle Gro Company 2003 Stock Option and Incentive Equity Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2003 Stock Option and Incentive Equity Plan)	Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 2005 (File No. 1-13292) [Exhibit 10(u)]
10(k)(2)	Form of letter agreement amending Restricted Stock awards granted under The Scotts Miracle-Gro Company 2003 Stock Option and Incentive Equity Plan, as amended (effective as of October 30, 2007)	*
10(l)	Specimen form of Award Agreement for Directors used to evidence Nonqualified Stock Options granted under The Scotts Miracle-Gro Company 2003 Stock Option and Incentive Equity Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2003 Stock Option and Incentive Equity Plan)	Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 2005 (File No. 1-13292) [Exhibit 10(v)]
10(m)	Employment Agreement effective as of October 1, 2007, between The Scotts Company LLC and Barry W. Sanders	*
10(n)	Employment Agreement effective as of July 1, 2001, between The Scotts Company LLC and Claude Lopez [English Translation Original in French]	*
10(o)	Employment Agreement for Christopher Nagel, entered into effective as of October 1, 2006, by and between Christopher Nagel and The Scotts Miracle-Gro Company (voluntarily terminated effective July 18, 2007)	Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed December 7, 2006 (File No. 1-13292) [Exhibit 10.1]
10(p)	The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan Award Agreement for Employees, evidencing Restricted Stock Award of 38,000 Restricted Stock Awarded to Christopher Nagel on October 1, 2006 by The Scotts Miracle-Gro Company (forfeited as a result of voluntary termination effective July 18, 2007)	Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed December 7, 2006 (File No. 1-13292) [Exhibit 10.2]
10(q)	Separation Agreement and General Release, entered into and effective as of July 18, 2007, by and between The Scotts Miracle-Gro Company and Christopher L. Nagel	Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed July 18, 2007 (File No. 1-13292) [Exhibit 10.1]
10(r)(1)	The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (as approved by the shareholders of The Scotts Miracle-Gro Company on January 26, 2006)	Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed February 2, 2006 (File No. 1-13292) [Exhibit 10.2]
10(r)(2)	The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan (effective as of October 30, 2007)	*



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Exhibit No.	Description	Location
10(s)	Specimen form of Award Agreement used to evidence Time-Based Nonqualified Stock Options for Non-Employee Directors under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan)	Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed February 2, 2006 (File No. 1-13292) [Exhibit 10.3]
10(t)(1)	Specimen form of Award Agreement used to evidence awards of Restricted Stock Units, Performance Shares, Nonqualified Stock Options, Incentive Stock Options, Restricted Stock and Stock Appreciation Rights which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan), used prior to October 30, 2007	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005 (File No. 1-13292) [Exhibit 10(b)]
10(t)(2)	Form of letter agreement amending Restricted Stock awards granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan, as amended (effective as of October 30, 2007)	*
10(t)(3)	Specimen form of Nonqualified Stock Option Award Agreement for Employees to evidence grants of Nonqualified Stock Options which may be made under The Scotts Miracle-Gro Company [Amended and Restated] 2006 Long-Term Incentive Plan (used after October 30, 2007)	*
10(t)(4)	Specimen form of Restricted Stock Award Agreement for Employees to evidence grants of Restricted Stock which may be made under The Scotts Miracle-Gro Company [Amended and Restated] 2006 Long-Term Incentive Plan (used after October 30, 2007)	*
10(t)(5)	Specimen form of Performance Share Award Agreement for Employees (with Related Dividend Equivalents) to evidence grants of Performance Shares which may be made under The Scotts Miracle-Gro Company [Amended and Restated] 2006 Long-Term Incentive Plan (used after October 30, 2007)	*
10(u)	Specimen form of Award Agreement for Third Party Service Providers used to evidence awards which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan) to third party service providers	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended July 1, 2006 (File No. 1-13292) [Exhibit 10.3]
10(v)	Specimen form of Award Agreement for Employees used to evidence Nonqualified Stock Options, Restricted Stock and Restricted Stock Units which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended December 30, 2006 (File No. 1-13292) [Exhibit 10.1]

Restated 2006 Long-Term Incentive Plan) (Standard  
International Specimen covering Australian, Canadian and The  
Netherlands)

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Exhibit No.	Description	Location
10(w)	Specimen form of Award Agreement for Employees used to evidence Stock Options, Restricted Stock and Restricted Stock Units which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan) (Austrian Specimen)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended December 30, 2006 (File No. 1-13292) [Exhibit 10.2]
10(x)	Specimen form of Award Agreement for Employees used to evidence Nonqualified Stock Options which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan) (Belgian Specimen)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended December 30, 2006 (File No. 1-13292) [Exhibit 10.3]
10(y)	Specimen form of Award Agreement for Employees used to evidence Nonqualified Stock Options, Restricted Stock, Restricted Stock Units and Performance Shares which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan) (French Specimen)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended December 30, 2006 (File No. 1-13292) [Exhibit 10.4]
10(z)	Specimen form of Award Agreement for Employees used to evidence Nonqualified Stock Options which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan) (German Specimen)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended December 30, 2006 (File No. 1-13292) [Exhibit 10.5]
10(aa)	Specimen form of Award Agreement for Employees used to evidence Nonqualified Stock Options which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan) (Polish Specimen)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended December 30, 2006 (File No. 1-13292) [Exhibit 10.6]
10(bb)	Specimen form of Award Agreement for United Kingdom Employees used to evidence Nonqualified Stock Options, Restricted Stock and Restricted Stock Units which may be granted under The Scotts Miracle-Gro Company 2006 Long-Term Incentive Plan (now known as The Scotts Miracle-Gro Company Amended and Restated 2006 Long-Term Incentive Plan) (United Kingdom Specimen)	Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended December 30, 2006 (File No. 1-13292) [Exhibit 10.7]
10(cc)	The Scotts Miracle-Gro Company Discounted Stock Purchase Plan (As Amended and Restated as of January 26, 2006; Reflects 2-for-1 Stock Split Distributed on November 9, 2005)	Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed February 2, 2006 (File No. 1-13292) [Exhibit 10.1]
10(dd)	Summary of Compensation for Directors of The Scotts Miracle-Gro Company	*

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10(ee)	Separation Agreement and General Release, entered into and effective as of July 17, 2007 by and between The Scotts Miracle-Gro Company and David M. Aronowitz	Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed July 17, 2007 (File No. 1-13292) [Exhibit 10.1]
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\* Filed herewith.



(b) EXHIBITS

The exhibits listed on the Index to Exhibits beginning on page 102 of this Annual Report on Form 10-K are filed with this Annual Report on Form 10-K or incorporated herein by reference as noted in the Index to Exhibits .

(c) FINANCIAL STATEMENT SCHEDULE

The financial statement schedule filed with this Annual Report on Form 10-K is submitted in a separate section hereof. For a description of such financial statement schedule, see Index to Consolidated Financial Statements and Financial Statement Schedule on page 53 of this Annual Report on Form 10-K.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: November 29, 2007

THE SCOTTS MIRACLE-GRO COMPANY

By:

/s/ James Hagedorn

James Hagedorn, President, Chief Executive Officer and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Mark R. Baker*	Director	November 29, 2007
Mark R. Baker		
/s/ Gordon F. Brunner*	Director	November 29, 2007
Gordon F. Brunner		
/s/ Arnold W. Donald*	Director	November 29, 2007
Arnold W. Donald		
/s/ David C. Evans	Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	November 29, 2007
David C. Evans		
/s/ Joseph P. Flannery*	Director	November 29, 2007
Joseph P. Flannery		
/s/ James Hagedorn	President, Chief Executive Officer, Chairman of the Board and Director (Principal Executive Officer)	November 29, 2007
James Hagedorn		
/s/ Thomas N. Kelly Jr.*	Director	November 29, 2007
Thomas N. Kelly Jr.		

/s/ Katherine Hagedorn Littlefield*	Director	November 29, 2007
Katherine Hagedorn Littlefield		
/s/ Karen G. Mills*	Director	November 29, 2007
Karen G. Mills		
/s/ Nancy G. Mistretta*	Director	November 29, 2007
Nancy G. Mistretta		
/s/ Patrick J. Norton*	Director	November 29, 2007
Patrick J. Norton		

Signature	Title	Date
/s/ Stephanie M. Shern*	Director	November 29, 2007
Stephanie M. Shern		
/s/ John S. Shiely*	Director	November 29, 2007
John S. Shiely		

\* The undersigned, by signing his name hereto, does hereby sign this Report on behalf of each of the directors of the Registrant identified above pursuant to Powers of Attorney executed by the directors identified above, which Powers of Attorney are filed with this Report as exhibits.

By: /s/ David C. Evans

David C. Evans, Attorney-in-Fact

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS  
AND FINANCIAL STATEMENT SCHEDULE**

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Schedules other than the schedule listed above are omitted since they are not required or are not applicable, or the required information is shown in the Consolidated Financial Statements or Notes thereto.

## **ANNUAL REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of The Scotts Miracle-Gro Company and our consolidated subsidiaries; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of The Scotts Miracle-Gro Company and our consolidated subsidiaries are being made only in accordance with authorizations of management and directors of The Scotts Miracle-Gro Company and our consolidated subsidiaries, as appropriate; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the assets of The Scotts Miracle-Gro Company and our consolidated subsidiaries that could have a material effect on the consolidated financial statements.

Management, with the participation of our principal executive officer and principal financial officer, assessed the effectiveness of our internal control over financial reporting as of September 30, 2007, the end of our fiscal year. Management based its assessment on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies and our overall control environment. This assessment is supported by testing and monitoring performed under the direction of management.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluations of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Accordingly, even an effective system of internal control over financial reporting will provide only reasonable assurance with respect to financial statement preparation.

Based on our assessment, management has concluded that our internal control over financial reporting was effective as of September 30, 2007, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America. We reviewed the results of management's assessment with the Audit Committee of The Scotts Miracle-Gro Company.

Our independent registered public accounting firm, Deloitte & Touche LLP, independently audited our internal control over financial reporting and has issued their report which appears herein.

/s/ James Hagedorn

James Hagedorn  
President, Chief Executive Officer  
and Chairman of the Board  
Dated: November 29, 2007

/s/ David C. Evans

David C. Evans  
Executive Vice President  
and Chief Financial Officer  
Dated: November 29, 2007



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
The Scotts Miracle-Gro Company  
Marysville, Ohio

We have audited the accompanying consolidated balance sheets of The Scotts Miracle-Gro Company and Subsidiaries (the Company) as of September 30, 2007 and 2006, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended September 30, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2007, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements on September 30, 2007 the Company adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of September 30, 2007, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated November 29, 2007 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Columbus, Ohio  
November 29, 2007



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
The Scotts Miracle-Gro Company  
Marysville, Ohio

We have audited the internal control over financial reporting of The Scotts Miracle-Gro Company and Subsidiaries (the Company) as of September 30, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Annual Report of Management on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2007, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended September 30, 2007 of the Company and our report dated November 29, 2007 expressed an unqualified opinion on those financial statements, and included an explanatory paragraph relating to the Company's adoption of Statement of Financial Accounting Standards No. 158,

*Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* on September 30, 2007.

/s/ Deloitte & Touche LLP

Columbus, Ohio

November 29, 2007

**The Scotts Miracle-Gro Company**  
**Consolidated Statements of Operations**  
**for the fiscal years ended September 30, 2007, 2006 and 2005**  
**(in millions, except per share data)**

	2007	2006	2005
Net sales	\$ 2,871.8	\$ 2,697.1	\$ 2,369.3
Cost of sales	1,867.3	1,741.1	1,509.2
Restructuring and other charges		0.1	(0.3)
Gross profit	1,004.5	955.9	860.4
Operating expenses:			
Selling, general and administrative	700.9	636.9	633.8
Impairment, restructuring and other charges	38.0	75.7	33.2
Other income, net	(11.5)	(9.2)	(7.5)
Income from operations	277.1	252.5	200.9
Costs related to refinancings	18.3		1.3
Interest expense	70.7	39.6	41.5
Income before income taxes	188.1	212.9	158.1
Income taxes	74.7	80.2	57.7
Income from continuing operations	113.4	132.7	100.4
Income from discontinued operations			0.2
Net income	\$ 113.4	\$ 132.7	\$ 100.6
Basic earnings per common share:			
Income from continuing operations	\$ 1.74	\$ 1.97	\$ 1.51
Income from discontinued operations			
Net income	\$ 1.74	\$ 1.97	\$ 1.51
Diluted earnings per common share:			
Income from continuing operations	\$ 1.69	\$ 1.91	\$ 1.47
Income from discontinued operations			
Net income	\$ 1.69	\$ 1.91	\$ 1.47

See Notes to Consolidated Financial Statements.

**The Scotts Miracle-Gro Company**  
**Consolidated Statements of Cash Flows**  
**for the fiscal years ended September 30, 2007, 2006 and 2005**  
**(in millions)**

	2007	2006	2005
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 113.4	\$ 132.7	\$ 100.6
Adjustments to reconcile net income to net cash provided by operating activities:			
Impairment and other charges	38.0	66.4	23.4
Costs related to refinancings	18.3		1.3
Stock-based compensation expense	13.3	15.7	10.7
Depreciation	51.4	51.0	49.6
Amortization	16.1	16.0	17.6
Deferred taxes	6.3	(0.4)	(13.6)
Gain on sale of property, plant and equipment	(0.4)	(0.5)	
Changes in assets and liabilities, net of acquired businesses:			
Accounts receivable	(4.2)	(37.6)	(37.9)
Inventories	13.2	(60.6)	(15.8)
Prepaid and other current assets	(6.9)	(3.6)	8.1
Accounts payable	(3.5)	34.3	10.3
Accrued taxes and liabilities	(2.0)	(33.4)	27.9
Restructuring reserves	(5.0)	(9.2)	10.3
Other non-current items	6.8	2.0	6.6
Other, net	(8.2)	9.6	27.6
Net cash provided by operating activities	246.6	182.4	226.7
<b>INVESTING ACTIVITIES</b>			
Redemption of available for sale securities			57.2
Proceeds from sale of property, plant and equipment	0.5	1.3	
Investment in property, plant and equipment	(54.0)	(57.0)	(40.4)
Investments in acquired businesses, net of cash acquired	(18.7)	(118.4)	(77.7)
Net cash used in investing activities	(72.2)	(174.1)	(60.9)
<b>FINANCING ACTIVITIES</b>			
Borrowings under revolving and bank lines of credit and term loans	2,519.2	746.9	924.2
Repayments under revolving and bank lines of credit and term loans	(1,710.5)	(691.7)	(736.4)
Repayment of term loans			(399.0)
Repayment of 65/8% senior subordinated notes	(209.6)		
Financing and issuance fees	(13.0)		(3.6)
Dividends paid	(543.6)	(33.5)	(8.6)
Payments on sellers notes	(2.7)	(4.5)	(6.9)
Purchase of common shares	(246.8)	(87.9)	

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Excess tax benefits from share-based payment arrangements	19.0	6.2	
Cash received from exercise of stock options	29.2	17.6	32.2
Proceeds from termination of interest rate swaps			2.9
Net cash used in financing activities	(158.8)	(46.9)	(195.2)
Effect of exchange rate changes	4.2	6.5	(6.0)
Net increase (decrease) in cash	19.8	(32.1)	(35.4)
Cash and cash equivalents, beginning of year	48.1	80.2	115.6
Cash and cash equivalents, end of year	\$ 67.9	\$ 48.1	\$ 80.2
SUPPLEMENTAL CASH FLOW INFORMATION			
Interest paid, net of interest capitalized	(75.9)	(38.2)	(39.9)
Income taxes paid	(65.2)	(60.3)	(64.0)

See Notes to Consolidated Financial Statements.

**The Scotts Miracle-Gro Company****Consolidated Balance Sheets  
September 30, 2007 and 2006  
(in millions except per share data)**

	2007	2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 67.9	\$ 48.1
Accounts receivable, less allowances of \$11.4 in 2007 and \$11.3 in 2006	248.3	380.4
Accounts receivable pledged	149.5	
Inventories, net	405.9	409.2
Prepaid and other assets	127.7	104.3
Total current assets	999.3	942.0
Property, plant and equipment, net	365.9	367.6
Goodwill	462.9	458.1
Intangible assets, net	418.8	424.7
Other assets	30.3	25.2
Total assets	\$ 2,277.2	\$ 2,217.6
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of debt	\$ 86.4	\$ 6.0
Accounts payable	202.5	200.4
Accrued liabilities	286.8	269.1
Accrued taxes	10.9	20.7
Total current liabilities	586.6	496.2
Long-term debt	1,031.4	475.2
Other liabilities	179.9	164.5
Total liabilities	1,797.9	1,135.9
Commitments and contingencies (Notes 15, 16 and 17)		
Shareholders' equity:		
Common shares and capital in excess of \$.01 stated value per share; shares issued and outstanding of 64.1 in 2007 and 66.6 in 2006	480.3	509.1
Retained earnings	260.5	690.7
Treasury shares, at cost; 4.0 shares in 2007 and 1.5 shares in 2006	(219.5)	(66.5)
Accumulated other comprehensive loss	(42.0)	(51.6)

Total shareholders' equity	479.3	1,081.7
Total liabilities and shareholders' equity	\$ 2,277.2	\$ 2,217.6

See Notes to Consolidated Financial Statements.

**The Scotts Miracle-Gro Company**  
**Consolidated Statements of Shareholders' Equity**  
**for the fiscal years ended September 30, 2007, 2006 and 2005**  
**(in millions)**

	Common Stock		Capital in Excess of Stated Value	Deferred Compensation	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(loss)		Total
	Shares	Amount				Shares	Amount		
Balance, September 30, 2004	65.7	\$ 0.3	\$ 443.0	\$ (10.4)	\$ 499.5		\$	\$ (57.8)	\$ 874.6
Net income					100.6				100.6
Foreign currency translation								4.1	4.1
Unrecognized gain on derivatives, net of tax								2.1	2.1
Minimum pension liability, net of tax								(5.0)	(5.0)
Comprehensive income									101.8
Stock-based compensation awarded			15.1	(15.1)					
Stock-based compensation forfeitures			(2.6)	2.6					
Stock-based compensation expense				10.7					10.7
Cash dividends paid (\$0.125 per share)					(8.6)				(8.6)
Issuance of common shares	2.1		47.7						47.7
Balance, September 30, 2005	67.8	0.3	503.2	(12.2)	591.5			(56.6)	1,026.2
Net income					132.7				132.7
Foreign currency translation								(1.5)	(1.5)
FAS 123(R) reclassification			(12.2)	12.2					
Minimum pension liability, net of tax								6.5	6.5
Comprehensive income									137.7
Stock-based compensation expense			15.7						15.7
Cash dividends paid (\$0.50 per share)					(33.5)				(33.5)
Treasury stock purchases						2.0	(87.9)		(87.9)



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Treasury stock issuances			(21.4)		(0.5)	21.4		
Issuance of common shares	0.3		23.5					23.5
Balance, September 30, 2006	68.1	0.3	508.8	690.7	1.5	(66.5)	(51.6)	1,081.7
Net income				113.4				113.4
Foreign currency translation							4.9	4.9
Unrecognized gain (loss) on derivatives, net of tax							(2.4)	(2.4)
Minimum pension liability, net of tax							20.4	20.4
Comprehensive income								136.3
Adjustment to initially apply SFAS 158, net of tax							(13.3)	(13.3)
Stock-based compensation expense (non cash)			13.3					13.3
Cash dividends paid (\$8.50 per share)				(543.6)				(543.6)
Treasury stock purchases					4.5	(246.8)		(246.8)
Treasury stock issuances			(42.1)		(2.0)	93.8		51.7
Balance, September 30, 2007	68.1	\$ 0.3	\$ 480.0	\$ 260.5	4.0	\$ (219.5)	\$ (42.0)	\$ 479.3

See Notes to Consolidated Financial Statements.

**The Scotts Miracle-Gro Company**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations**

The Scotts Miracle-Gro Company ( Scotts Miracle-Gro ) and its subsidiaries (collectively, the Company ) are engaged in the manufacture, marketing and sale of lawn and garden care products. The Company's major customers include home improvement 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. The Company's products are sold primarily in North America and the European Union. We also operate the Scotts LawnService® business which provides lawn and tree and shrub fertilization, insect control and other related services in the United States and Smith & Hawken®, a leading brand in the outdoor living and gardening lifestyle category. Effective November 18, 2005, the Company entered the North America wild bird food category with the acquisition of Gutwein & Co., Inc. ( Gutwein ).

Due to the nature of the lawn and garden business, the majority of shipments to retailers occur in the Company's second and third fiscal quarters. On a combined basis, net sales for the second and third fiscal quarters generally represent 70% to 75% of annual net sales.

**Organization and Basis of Presentation**

The Company's consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of Scotts Miracle-Gro and all wholly-owned and majority-owned subsidiaries. All intercompany transactions and accounts are eliminated in consolidation. The Company's criteria for consolidating entities is based on majority ownership (as evidenced by a majority voting interest in the entity) and an objective evaluation and determination of effective management control.

**Revenue Recognition**

Revenue is recognized when title and risk of loss transfer, which generally occurs when products are received by the customer. Provisions for estimated returns and allowances are recorded at the time revenue is recognized based on historical rates and are periodically adjusted for known changes in return levels. Shipping and handling costs are included in cost of sales. Scotts LawnService® revenues are recognized at the time service is provided to the customer.

Under the terms of the Amended and Restated Exclusive Agency and Marketing Agreement (the Marketing Agreement ) between the Company and Monsanto Company ( Monsanto ), the Company, in its role as exclusive agent, performs certain functions, such as sales support, merchandising, distribution and logistics, and incurs certain costs in support of the consumer Roundup® business. The actual costs incurred by the Company on behalf of Roundup® are recovered from Monsanto through the terms of the Marketing Agreement. The reimbursement of costs for which the Company is considered the primary obligor is included in net sales.

**Promotional Allowances**

The Company promotes its branded products through cooperative advertising programs with retailers. Retailers also are offered in-store promotional allowances and rebates based on sales volumes. Certain products are promoted with

direct consumer rebate programs and special purchasing incentives. Promotion costs (including allowances and rebates) incurred during the year are expensed to interim periods in relation to revenues and are recorded as a reduction of net sales. Accruals for expected payouts under the programs are included in the Accrued liabilities line in the Consolidated Balance Sheets.

### **Advertising**

The Company advertises its branded products through national and regional media. Advertising costs incurred during the year are expensed to interim periods in relation to revenues. All advertising costs, except for external production costs, are expensed within the fiscal year in which such costs are

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

incurred. External production costs for advertising programs are deferred until the period in which the advertising is first aired.

Scotts LawnService® promotes its service offerings primarily through direct mail campaigns. External costs associated with these campaigns that qualify as direct response advertising costs are deferred and recognized as advertising expense in proportion to revenues over a period not beyond the end of the subsequent calendar year. Costs that are not direct advertising costs are expensed within the fiscal year incurred on a monthly basis in proportion of net sales. The costs deferred at September 30, 2007 and 2006 were \$5.7 million and \$5.6 million, respectively.

Advertising expenses were \$150.9 million in fiscal 2007, \$137.3 million in fiscal 2006 and \$122.5 million in fiscal 2005.

### **Research and Development**

All costs associated with research and development are charged to expense as incurred. Expense for fiscal 2007, 2006 and 2005 was \$38.8 million, \$35.1 million and \$38.0 million including registrations of \$9.3 million, \$8.2 million and \$7.5 million, respectively.

### **Environmental Costs**

The Company recognizes environmental liabilities when conditions requiring remediation are probable and the amounts can be reasonably estimated. Expenditures which extend the life of the related property or mitigate or prevent future environmental contamination are capitalized. Environmental liabilities are not discounted or reduced for possible recoveries from insurance carriers.

### **Stock-Based Compensation Awards**

In fiscal 2003, the Company began expensing prospective grants of employee stock-based compensation awards in accordance with SFAS 123, Accounting for Stock-Based Compensation. The Company adopted SFAS 123(R), Share-Based Payment effective October 1, 2005, following the modified prospective application approach. The Company was already in substantial compliance with SFAS 123(R) at the adoption date as SFAS 123(R) closely parallels SFAS 123. The fair value of awards is expensed ratably over the vesting period, generally three years, except for grants to members of the Board of Directors of Scotts Miracle-Gro that have a shorter vesting period. The Company uses a binomial model to fair value its option grants.

### **Earnings per Common Share**

Basic earnings per common share is computed based on the weighted-average number of common shares outstanding each period. Diluted earnings per common share is computed based on the weighted-average number of common shares and dilutive potential common shares (stock options, restricted stock, performance shares and stock appreciation rights) outstanding each period.

### **Cash and Cash Equivalents**

The Company considers all highly liquid financial instruments with original maturities of three months or less to be cash equivalents. The Company maintains cash deposits in banks which from time to time exceed the amount of

deposit insurance available. Management periodically assesses the financial condition of the institutions and believes that any potential credit loss is minimal.

**Accounts Receivable and Allowances**

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Allowances reflect our best estimate of amounts in our existing accounts receivable that may not be collected due to customer claims, the return of goods, or customer inability or unwillingness to pay. We determine the allowance based on customer risk assessment and historical experience. We review our allowances monthly. Past due balances over 90 days and in excess of a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by type of receivable. Account

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

balances are charged off against the allowance when we feel it is probable the receivable will not be recovered. We do not have any off-balance-sheet credit exposure related to our customers.

### **Inventories**

Inventories are stated at the lower of cost or market, principally determined by the FIFO method. Certain growing media inventories are accounted for by the LIFO method. Approximately 5% of inventories were valued at the lower of LIFO cost or market at September 30, 2007 and 2006. Inventories include the cost of raw materials, labor, manufacturing overhead, and freight and in-bound handling costs incurred to pre-position goods in the Company's warehouse network. The Company makes provisions for obsolete or slow-moving inventories as necessary to properly reflect inventory at the lower of cost or market value. Reserves for excess and obsolete inventories were \$15.6 million and \$15.1 million at September 30, 2007 and 2006, respectively.

### **Goodwill and Indefinite-lived Intangible Assets**

In accordance with SFAS 142, Goodwill and Other Intangible Assets, goodwill and intangible assets determined to have indefinite lives are not subject to amortization. Goodwill and indefinite-lived intangible assets are reviewed for impairment by applying a fair-value based test on an annual basis or more frequently if circumstances indicate a potential impairment. If it is determined that an impairment has occurred, an impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its estimated fair value and classified as Impairment, restructuring and other charges in the Consolidated Statement of Operations.

During the third quarter of fiscal 2007, the Company changed the timing of its annual goodwill impairment testing from the last day of the fiscal first quarter to the first day of the fiscal fourth quarter. As such, the annual impairment test was performed as of December 30, 2006 and was performed again as of July 1, 2007. This accounting is preferable in the circumstances as moving the timing of our annual goodwill impairment testing better aligns with the seasonal nature of the business and the timing of the annual strategic planning process. The Company believes that this change in accounting principle will not delay, accelerate, or avoid an impairment charge. In addition, the Company also changed the date of its annual indefinite life intangible impairment testing to the first day of the fiscal fourth quarter for the current year. The Company determined that the change in accounting principle related to the annual testing date does not result in adjustments to the financial statements applied retrospectively.

### **Long-lived Assets**

Property, plant and equipment are stated at cost. Interest capitalized on capital projects amounted to \$0.4 million, \$0.5 million and \$0.3 million during fiscal 2007, fiscal 2006 and fiscal 2005, respectively. Expenditures for maintenance and repairs are charged to expense as incurred. When properties are retired or otherwise disposed of, the cost of the asset and the related accumulated depreciation are removed from the accounts with the resulting gain or loss being reflected in income from operations.

Depreciation of property, plant and equipment is provided on the straight-line method and is based on the estimated useful economic lives of the assets as follows:

Land improvements	10	25 years
Buildings	10	40 years

Machinery and equipment	3	15 years
Furniture and fixtures	6	10 years
Software	3	8 years

Intangible assets with finite lives, and therefore subject to amortization, include technology (e.g., patents), customer accounts, and certain tradenames. These intangible assets are being amortized on the straight-line method over periods typically ranging from 10 to 25 years. The Company's fixed assets and intangible assets subject to amortization are required to be tested for recoverability under SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### **Internal Use Software**

The Company accounts for the costs of internal use software in accordance with Statement of Position 98-1,

Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Accordingly, costs are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage or the post-implementation/operation stage. As of September 30, 2007 and 2006, the Company had \$31.1 million and \$29.4 million, respectively, in unamortized capitalized internal use computer software costs. Amortization of these costs was \$12.1 million, \$10.7 million and \$9.6 million during fiscal 2007, 2006 and 2005, respectively.

### **Accruals for Self-Insured Losses**

The Company maintains insurance for certain risks, including workers' compensation, general liability and vehicle liability, and is self-insured for employee related health care benefits. The Company accrues for the expected costs associated with these risks by considering historical claims experience, demographic factors, severity factors, and other relevant information. Costs are recognized in the period the claim is incurred, and the financial statement accruals include an actuarially determined estimate of claims incurred but not yet reported.

### **Translation of Foreign Currencies**

For all foreign operations, the functional currency is the local currency. Assets and liabilities of these operations are translated at the exchange rate in effect at each year-end. Income and expense accounts are translated at the average rate of exchange prevailing during the year. Translation gains and losses arising from the use of differing exchange rates from period to period are included in other comprehensive income, a component of shareholders' equity. Foreign currency transaction gains and losses are included in the determination of net income and amounted to a loss of \$0.2 million, a loss of \$0.7 million and a gain of \$2.1 million in fiscal years 2007, 2006 and 2005, respectively.

### **Derivative Instruments**

In the normal course of business, the Company is exposed to fluctuations in interest rates, the value of foreign currencies, and the cost of commodities. A variety of financial instruments, including forward and swap contracts, are used to manage these exposures. The Company's objective in managing these exposures is to better control these elements of cost and mitigate the earnings and cash flow volatility associated with changes in the applicable rates and prices.

The Company has established policies and procedures that encompass risk-management philosophy and objectives, guidelines for derivative-instrument usage, counterparty credit approval, and the monitoring and reporting of derivative activity. The Company does not enter into derivative instruments for the purpose of speculation.

### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying 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.



**Variable Interest Entities**

Financial Accounting Standards Board (FASB) Interpretation 46(R), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46(R)) provides a framework for identifying variable interest entities (VIEs) and determining when a company should include the assets, liabilities, noncontrolling interests, and results of operations of a VIE in its consolidated financial statements. In general, a VIE is a corporation, partnership, limited liability company, trust, or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that are

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

unable to make significant decisions about its activities, or (3) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns generated by its operations.

FIN 46(R) requires a VIE to be consolidated if a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is obligated to absorb a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party absorbs a majority of the VIE's losses), or both. A variable interest holder that consolidates the VIE is called the primary beneficiary. Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and noncontrolling interests at fair value and subsequently account for the VIE as if it were consolidated based on majority voting interest. FIN 46(R) also requires disclosures about VIEs that the variable interest holder is not required to consolidate but in which it has a significant variable interest.

The Company's Scotts LawnService® business sells new franchise territories, primarily in small to mid-size markets, under arrangements where a portion of the franchise fee is paid in cash with the balance due under a promissory note. The Company believes that it may be the primary beneficiary for certain of its franchisees initially, but ceases to be the primary beneficiary as the franchisees develop their businesses and the promissory notes are repaid. At September 30, 2007, the Company had approximately \$2.3 million in notes receivable from such franchisees. The effect of consolidating the entities where the Company may be the primary beneficiary for a limited period of time is not material to either the Consolidated Statements of Operations or the Consolidated Balance Sheets.

### **New Accounting Pronouncements**

#### **Statement of Financial Accounting Standards No. 158 – Employers' Accounting For Defined Benefit Pension And Other Postretirement Plans**

In September 2006, the Financial Accounting Standards Board issued SFAS 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R). The Company adopted the recognition and disclosure provisions of SFAS 158 as required on September 30, 2007. SFAS 158 requires the Company to record non-cash adjustments to recognize the funded status of each of its defined pension and postretirement benefit plans, measured as the difference between the plan assets and the benefit obligation, as a net asset or liability in its statement of financial position with an offsetting amount in accumulated other comprehensive income or loss, and to recognize changes in that funded status in the year in which changes occur through comprehensive income or loss. The Company was already in compliance with the SFAS 158 requirement to measure plan assets and liabilities as of the Company's fiscal year end. The adoption of SFAS 158 had no effect on the Company's Consolidated Statement of Operations for any period presented, and it will not affect the Company's operating results in future periods. SFAS 158 does not change the way the Company measures plan assets and benefit obligations or the determination of net periodic benefit cost. The following table reflects the effects of the adoption of SFAS 158 on the Company's Consolidated Balance Sheet as of September 30, 2007. See the related footnote disclosures in Note 8, Retirement Plans and Note 9, Associate Medical Benefits.

Prior to Adopting SFAS 158	Effect of Adopting SFAS 158	As Reported under SFAS 158
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(In millions)

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Prepaid and other assets	\$	136.8	\$	(9.1)	\$	127.7
Accrued liabilities		283.1		3.7		286.8
Other liabilities		179.4		0.5		179.9
Total liabilities		1,793.7		4.2		1,797.9
Accumulated other comprehensive gain (loss)		(28.7)		(13.3)		(42.0)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### **Statement of Financial Accounting Standards No. 157 Fair Value Measurements**

In September 2006, the Financial Accounting Standards Board issued SFAS 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The Company will be required to adopt SFAS 157 no later than October 1, 2008, the beginning of its 2009 fiscal year. The provisions of SFAS 157 should be applied prospectively to the beginning of the fiscal year in which SFAS 157 is initially applied, except with respect to certain financial instruments as defined by SFAS 157. The Company has not yet determined the effect, if any, that the adoption of SFAS 157 will have on its consolidated financial statements.

### **Statement of Financial Accounting Standards No. 159 -The Fair Value Option for Financial Assets and Financial Liabilities**

In February 2007, the Financial Accounting Standards Board issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities, which allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. Subsequent changes in fair value of these financial assets and liabilities would be recognized in earnings when they occur. SFAS 159 further establishes certain additional disclosure requirements. SFAS 159 is effective for the Company's financial statements for the fiscal year beginning on October 1, 2008, with earlier adoption permitted. No entity is permitted to apply SFAS 159 retrospectively to fiscal years preceding the effective date unless the entity chooses early adoption. Management is currently evaluating the impact and timing of the adoption of SFAS 159 on the Company's consolidated financial statements.

### **FIN 48 Accounting For Uncertainty In Income Taxes An Interpretation of FASB Statement No. 109**

In July 2006, the Financial Accounting Standards Board has issued Interpretation (FIN) 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is recognition. The enterprise determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the enterprise should presume that the position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. The second step is measurement. A tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial

reporting period in which that threshold is no longer met.

The Company is required to adopt the provisions of FIN 48 in respect of all the Company's tax positions as of October 1, 2007, the beginning of fiscal 2008. The cumulative effect of applying the provisions of the Interpretation will be reported as an adjustment to the opening balance of retained earnings for fiscal 2008. The Company is completing its evaluation of FIN 48 and does not expect its adoption in the first quarter of fiscal 2008 to have a material impact on its financial position or results of operations.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 2. RECAPITALIZATION

On December 12, 2006, the Company announced a recapitalization plan to return \$750 million to the Company's shareholders. This plan expanded and accelerated the previously announced five-year \$500 million share repurchase program (which was canceled) under which the Company repurchased \$87.9 million of its common shares during fiscal 2006. Pursuant to the recapitalization plan, on February 14, 2007, the Company completed a modified Dutch auction tender offer, resulting in the repurchase of 4.5 million of the Company's common shares for an aggregate purchase price of \$245.5 million (\$54.50 per share). On February 16, 2007, the Company's Board of Directors declared a special one-time cash dividend of \$8.00 per share (\$508 million in the aggregate), which was paid on March 5, 2007, to shareholders of record on February 26, 2007.

In order to fund these transactions, the Company entered into new credit facilities aggregating \$2.15 billion and terminated its prior credit facility. As part of this debt restructuring, the Company also conducted a cash tender offer for any and all of its outstanding 65/8% senior subordinated notes in an aggregate principal amount of \$200 million. Reference should be made to Note 10, Debt for further information as to the new credit facilities and the repayment and termination of the prior credit facility and the 65/8% senior subordinated notes.

The payment of the special one-time cash dividend required the Company to adjust the number of common shares subject to stock options and stock appreciation rights outstanding under the Company's share-based awards programs, as well as the price at which the awards may be exercised. Reference should be made to Note 11, Shareholders' Equity for further information. The Company's interest expense will be significantly higher for periods subsequent to the recapitalization transactions as a result of the borrowings incurred to fund the cash returned to shareholders. The following pro forma financial information has been compiled as if the Company had completed the recapitalization transactions as of October 1, 2005 for fiscal 2006 and as of October 1, 2006 for fiscal 2007. Borrowing rates in effect as of March 30, 2007 were used to compute pro forma interest expense. As the recapitalization involved a share repurchase, pro forma diluted common shares are also provided.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Pro Forma Financial Information (Unaudited) Year Ended September 30, 2007                      2006	
	(In millions, except per share data)	
Income before income taxes, as reported	\$ 188.1	\$ 212.9
Add back reported interest expense	70.7	39.6
Add back costs related to refinancing	18.3	
Deduct pro forma interest expense	(94.3)	(100.8)
Pro forma income before income taxes	\$ 182.8	\$ 151.7
Pro forma income taxes	72.5	57.3
Pro forma net income	\$ 110.3	\$ 94.4
Pro forma basic net income per common share	\$ 1.74	\$ 1.50
Pro forma diluted net income per common share	\$ 1.68	\$ 1.45
Reported interest expense	\$ 70.7	\$ 39.6
Incremental interest on recapitalization borrowings	21.8	53.0
New credit facilities interest rate differential	1.5	7.4
Incremental amortization of new credit facilities fees	0.3	0.8
Pro forma interest expense	\$ 94.3	\$ 100.8
Pro forma effective tax rates	39.7%	37.8%
	Pro Forma Shares Year Ended September 30, 2007                      2006	
	(In millions)	
Weighted-average common shares outstanding during the period	65.2	67.5
Incremental full period impact of repurchased common shares	(1.8)	(4.5)
Pro forma basic common shares	63.4	63.0

Weighted-average common shares outstanding during the period plus dilutive potential common shares	67.0	69.4
Incremental full period impact of repurchased common shares	(1.8)	(4.5)
Impact on dilutive potential common shares	0.3	0.3
Pro forma diluted common shares	65.5	65.2



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 3. DETAIL OF CERTAIN FINANCIAL STATEMENT ACCOUNTS**

	2007	September 30, 2006
	(In millions)	
<b>INVENTORIES, NET:</b>		
Finished goods	\$ 289.9	\$ 267.4
Work-in-progress	28.3	