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SWK - Q1 2014 Stanley Black & Decker, Inc. Conference Call

EVENT DATE/TIME: APRIL 24, 2014 / 12:00PM GMT

OVERVIEW:

The co. announced 1Q14 GAAP EPS of $1.05. Management raised the bottom end of 2014 guidance to $5.35-5.50.

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PRESENTATION

Operator

Welcome to the Q1 2014 Stanley Black & Decker Incorporated earnings conference call. My name is Dawn, I will be the operator for today's call. At this time all participants are in a listen-only mode. Later we will conduct a question and answer session. Please note that this conference is being recorded.

I will now turn the call over to Vice President of Investor and Government Relations, Greg Waybright. Mr. Waybright, you may begin.

Greg Waybright - *Stanley Black & Decker Inc - VP, Investor & Government Relations*

Thank you, Dawn. Good morning, everyone, and thank you for joining us for Stanley Black & Decker's first quarter 2014 conference call. On the call, in addition to myself, is John Lundgren, our Chairman and CEO, Jim Loree, our President and COO, Don Allan, our Senior Vice President and CFO, and Jeff Ansell, our Senior Vice President and Group Executive Construction and DIY.

Our earnings release, which was issued earlier this morning, and a supplemental presentation which we will refer to during the call, are available on the IR section of our website, as well is on our iPhone and iPad app. A replay of this morning's call will also be available beginning at 2:00 PM today. The replay number and the access code are in our press release.

This morning, John, Jim, Don and Jeff will review Stanley's first quarter 2014 results and various other matters followed by a Q&A section. Because of the size of the queue, we are going to be sticking with just one question per caller.

As we normally do, we will be making some forward-looking statements during the call. Such statements are based on assumptions of future events that may not prove to be accurate and as such, may involve risk and uncertainty. It is therefore possible that actual results may differ materially from any forward-looking statements that we might make today. We direct you to the cautionary statements in the 8-K that we filed with our press release in our in most recent 34 Act filing.

I will now turn the call over to our Chairman and CEO, John Lundgren.

John Lundgren - *Stanley Black & Decker Inc - Chairman & CEO*

Thanks, Greg, and good morning, everybody. As Greg mentioned, this morning, in addition to Don Allan and Jim Loree, we have Jeff Ansell, an additional colleague with us this morning. And as most of you know, Jeff runs our CDIY business. I will stay at a high level in my introductory comments and let Jeff dive a little deeper into CDIY, an outstanding quarter in CDIY, and Jim will give you a lot more granularity on both the industrial and the security segments before we open it up to Q&A.

Revenues up 7%, 4% of that was organic, and Infastech accounted for the majority of the difference between organic growth and total sales. [Our internal growth investments contributed almost 200 basis points to our growth in the first quarter] (corrected by company after the call). That program is really gaining some traction.

Margins expanded 30 basis points to 12.1%. We had a lot of focus on cost because during the quarter, we absorbed about $25 million of negative currency pressure. But the fact that we did a really good job controlling costs in general and indirect costs in particular, we achieved some volume leverage. And as Don explained on our January call, of that $25 million, about one-third is translational and two-thirds is transactional.

EPS was $1.07, $1.05 on a GAAP basis, and I think what will be good news to many of you, you'll see the convergence between GAAP and adjusted earnings as there were minimal special charges recorded in the first quarter, and it will be the same for the rest of this year.

CDIY industrial both posted compelling top and bottom line results. Jeff is going to give you more on CDIY, so I will just note that organic growth was 6% and every geographic region on the globe expanded. Industrial delivered 5% organic growth and 15.6% margins. That's a 170 basis point improvement versus first quarter 2013.

Looking at security, it is tracking to plan aside from the weather impact in North America, and security Europe is gaining some traction. It's not yet manifested in the financial performance. As suggested, Jim is going to give you a lot more detail where we are, where we are going with this business. We've got a lot going on, and in we think it's on the right track.

But as a consequence, we're increasing the low-end of our guidance in 2014, and we are going to reiterate our cash flow performance. We are saying -- taking the low-end up to $5.35 to $5.50. There's been a lot of volatility, a lot of uncertainty there that Don will talk about, and we are reaffirming $675 million in free cash flow. That's including the $250 million from a cash perspective of one-time payments. So, solid top and bottom line performance led by our CDIY and industrial tools businesses.

Looking very quickly at the sources of growth, the top line momentum continues and as I suggested, our organic growth investments are starting to gain traction. Volume was up 4%. Price was flat, leading to organic growth of 4% for the quarter. Acquisitions accounted for another 4%, and currency was a 1% headwind for a total of 7%.

On the acquisition front, we get more on the segments, but if you look at organic growth, the majority of our businesses grew 5% to 6% organically, and security, which represents about 20% of the business, was flat to slightly down. Jim will give you some more granularity.

On acquisitions, that's primarily Infastech, which closed in February 2013. That's going really well, adding a tremendous value, both strategically and economically, to our engineering fastening business. But that will anniversary in the first quarter and will become core going forward.

Very quickly at the regions, you've got more granularity in the appendix. The US was up 2%. Strong organic growth in most businesses. We did have some weather impact that affected parts of our security business, and to a lesser extent, CDIY and industrial. Europe a strong 4% with a tremendous performance in CDIY across the European region. The emerging markets were up 5%, with Asia somewhat stronger than Latin America as we continue to face both the economic, political and currency headwinds in Latin America.

Finally, the rest of the world, while it's a small percentage of the business, was up 8%. There's a lot going on there. Japan, which only counts for 2% of our business, was aided, probably with some orders pull forward. There's a consumption tax that went into effect in Japan on April 1, so there's probably a little bit of order pull forward there. Canada, which accounts for about 5% of our business, was up 9%. So, good, strong performance in the rest of the world, as well as the emerging markets.

Let me turn it over to Jeff Ansell, who is going to dive a little deeper into the terrific first quarter performance that his business does.

Jeff Ansell - *Stanley Black & Decker Inc - SVP & Group Executive of Construction and DIY*

Thank you, John. Turning to page 6, we will begin with revenues that, you can see the chart depicts revenues increased 6%, or $65 million during the quarter. The three elements of that growth story that give us confidence in the CDIY business going forward are as follows. It marks -- in terms of duration, it marks the fourth consecutive quarter of mid single-digit growth in the business.

In terms of pervasive new product development, we had growth in every strategic business unit as innovation led the increased demand from end users. And then finally, the third element of growth was around customer connectivity and market activation that led to pervasive growth across customers, channels and geographies as depicted below with Europe at plus 11%, North America plus 5% and emerging markets plus 7%.

So, we had growth in both the largest and emerging markets, driven by new product development, and consecutive sequential growth across four quarters. We feel quite good about the growth story. We did have profit expansion during the quarter as volume gains and intensive cost management offset severe currency pressure of approximately $20 million in the quarter.

In total, to sum up page 6, growth of 6% organically with all regions and strategic business units delivering that growth, combined with profitability and cost focus that enabled an offset of sizable currency headwinds that masked very solid operating leverage in the quarter.

Turning to page 7 to give you greater depth surrounding the sources of growth that enabled market share gain globally. We will start in the upper left portion of the chart in Europe. In the quarter, we had a great deal of success as it relates to innovation. Innovation drove growth in every strategic business unit across Europe.

With this new product development tailwind, we were able to expand our retail partnerships to drive mutually beneficial growth for our growth, deliver growth for our customers and vice versa. Not only did we deliver growth in Europe, but we delivered growth in every European market as well as every European country in the quarter. This marks, as the chart shows, the fourth consecutive quarter of growth in Europe. And while we expect positive growth in each of the quarters going forward in Europe, there will be pressure based on the comps that you see from that chart. We will expect positive growth in each of the quarters going forward, albeit potentially a lower growth percentage with that comp pressure.

Turning to the upper right quadrant of the chart, our Built in the USA initiative that launched in November of 2013, this initiative leverages our unique and pervasive US manufacturing footprint that we are convinced is a competitive advantage. It is over 300 products in totality across various SBUs, and it focuses on a variety of brands including DeWalt, Stanley, Porter Cable and Bostitch.

Our Built in the USA growth rates were accretive to the accelerated growth rates you saw on the previous page, meaning that it's delivering growth even beyond the core business. We'll probably give you the most confidence in the pictures that you see just below the words, retail registration in the boxes, industrial construction channel, as well as even trade unions. This initiative has gotten great support and building inertia.

Moving to the bottom left quadrant of the chart in the emerging markets, where we've added 300 plus feet on the Street in terms of commercial resource. Over 1,500 distributors now selling our product across the emerging markets. We've set up dedicated emerging markets power tool and hand tool strategic business units.

We have mid price point product developments that was accelerated by our strategic GQ power tool acquisition. And perhaps the best way to depict what's going on in the emerging markets would be this. In over less than a 24 month period, we've gone from concept from the people in this room to global -- to a structure, to a global supply chain with over 1,000 new products flowing through it to end users in markets all over the globe. I believe it's some of our best work to date.

And then finally, bottom right quadrant of the chart depicts new product development across the strategic business units. Two things to note. First rule of businesses is, keep what belongs to you or what you have.

Second rule of businesses is, if you want to be a growth company, take what belongs to someone else, and I think this chart depicts appropriately both of those things. If you look at the advances we've made in core products like going from brush to brushless cordless drills or auto locking tape rules, those things have held our core business in place and grown that core where we've also now expanded in terms of innovation into new products like cordless nailing and cordless grease gun, et cetera. Products that are highly incremental because they expand markets that we serve.

The combination of all those things led to what we thought was a very positive growth performance inside the quarter. Turn it over to Jim.

Jim Loree - *Stanley Black & Decker Inc - President & COO*

Thank you, Jeff. That is an impressive performance, considering the $20 million, or 170 basis points of FX headwind operating margin rate. With Europe up 11% organically, it's quite a statement about the momentum of the business.

As you can appreciate from the CDIY story, the Stanley Black and Decker merger which created the world's largest tool company with its array of powerful brands, its strength in power and hand tools, its global scale and its robust, organic growth culture has created strategic benefits which go beyond the $500 million plus cost synergies and the $300 million plus revenue synergies already realized. What we have created and what Jeff and his team have managed very well, is a strategically advantaged franchise which has the capability to continue to expand margins while growing at healthy organic rates and gaining share.

Now, moving to industrial. First quarter was another standout quarter for industrial with all three of the major businesses clicking on all cylinders and performing at a high level. Industrial OM was up $30 million, or 29% on 16% revenue growth with 170 basis points of operating margin rate expansion to 15.6%.

Infastech contributed $14 million of the $30 million OM increase, and the remaining $16 million was organic and operational. What makes this performance even more compelling was that the operating leverage was delivered in the face of an approximate 70 basis point currency headwinds to the OM rate.

Total industrial organic growth was 5%, acquisitions, in this case Infastech added 12 points and currency was a 1 point offset to sales. Industrial and automotive repair, or IAR, was up 5% organically, while engineered fastening and infrastructure each delivered 6% organic growth. This healthy growth facilitated the operating leverage which was complemented by strong productivity and tight cost controls.

Now, turning to IAR specifically. Organic growth was achieved across the globe with Europe and North America both up 6% and emerging markets up 7%. IAR's results were boosted by the company-wide growth initiative, in this case, smart tools and storage and emerging markets. Mac Tools, Proto and Facom all turned in strong performances.

Engineered fastening's organic growth was driven by legacy Emhart automotive business, which was up 11%. Outpacing global light vehicle production by a factor of 1.6 X, reflecting continued execution of their business model which involves development of new applications, recurring revenue, and increased per vehicle penetration. In addition, the Infastech integration is going very well, with all key results on track including sales, synergies and operating margin.

Within infrastructure, oil and gas delivered 11% organic growth on top of a 9% growth comp the year ago. As both onshore and offshore continue to perform well in the market and the market continued to be robust. I do remind you, however, that oil and gas faces very challenging organic growth comps for the remainder of the year as the remaining quarterly comps range between 32% and 43% organic growth. At the same time, onshore pipeline project activity is facing a lull in this period as pipeliners gear up for what is expected to be a record 2015.

In summary, we were very pleased with the performance in industrial during the quarter, and we continue to be bullish on this segment in total for the remainder of the year.

And now we move on to security. This segment, which continues to be a work in progress, experienced a 3% revenue decline in the quarter with the 4% organic decline. Segment OM decreased $12 million to $52 million and the OM rate decreased 170 basis points to 9.1%. Once again, it was a markedly different story in North America versus that in Europe.

North America, along with our small emerging markets unit, were down 1% organically taken together, and we believe US weather conditions exerted a modest downward pressure on that number. Encouragingly, the OM rate improved 40 basis points to 14.7%, and absolute OM dollars were essentially flat with 1Q 2013.

Note that this is the first quarter since 4Q 2012 that both America and emerging markets OM quarter over quarter did not decreased significantly. We see this as an inflection point and expect the reversion to positive OM dollar accretion to begin in second quarter and continue as the year progresses.

Importantly, we also expect this group to contribute positively to the Company's organic growth in 2014, especially in the second half. As the vertical market initiative is bearing fruit with the annualized order rate now running at $120 million, up from almost zero a year ago with the successes mounting, especially in retail and healthcare. So, stay tuned for more gains as we continue on through the year.

The story as it relates to Europe security is one of significant progress under the covers, which has not yet manifested itself in the P&L. I will touch upon the specifics in a moment, but first, here are the numbers for 1Q.

Organic sales were down 7% and OM was 1% versus 5.9% a year ago, representing a $12 million unfavorable OM headwind, which was steeper than expected. With that said, RMR attrition rate improved dramatically versus a year ago with a 340 basis points decrease, and this is a direct result of the intensive efforts we have made to implement basic attrition reduction processes in the various countries.

In addition, order rates continued on a positive trend with a 5% increase in the quarter on the heels of an 11% increase in 4Q. And clearly, the issue in the quarter was mobilizing the field to efficiently install the growing backlog. This is the same issue that we successfully addressed in North America in the back half of last year, and we are well into the process of implementing very similar fixes now in Europe.

In fact, the turnaround efforts for electronic security on both continents have followed or are following a very similar pattern. It starts with leadership upgrades, which in Europe have been extensive, but basically complete by last December. There has also been significant progress in creating a sales force in Europe comprised of hunters as opposed to individuals taking referrals from Securitas, their commercial partner in the pre-Stanley ownership era. The construction of the new sales force has been ongoing for about 18 months now and is well along, as you can see from the order rates.

The next step is to stem the RMR attrition down from 18% zone to closer to 10% to 12%. This is also well underway, as I referenced, and we were able to see the results in the year-over-year improvements. We expect this initiative, which consists of both procedures which respond to customers requesting termination, as well as proactive processes involving customer care and contact throughout their lifecycle. That also involves emphasizing RMR origination and growth through tweaking the go-to-market approach in areas such as sales force focus, sales incentive plans and marketing and sales communication.

Now, step four, which has been the most intensive focus area over the last 90 days, involves optimizing field operations, which means maximizing installation and service revenue, while doing it with the most efficient mix of labor, material and overhead content. The European team has made great strides during this period in producing key weekly metrics which enable vastly improved visibility to branch level activities, thus enabling management at various levels to hold the field organization accountable and monitor performance sufficiently to serve as both a management tool and a forecasting tool.

So, in summary, we have an informed perspective on where we are the turnaround process in Europe, and we are managing it as closely and aggressively as possible. While it is slower than we would like, we have a high level of confidence that we are moving the needle and that the results will be evident in the P&L in coming quarters.

What we now expect for Europe security for the second quarter is a significant improvement in the $12 million year-over-year OM decrease experienced in 1Q. We then expect Europe to shift to a positive contribution in either 3Q or 4Q. This trajectory would have total segment OM dollars flatish to nominally down in second quarter and then rebounding to OM dollar accretive in the second half.

To simplify the guidance for the Company and adopt a prudent and conservative stance, we have zeroed out any increase in OM dollar contribution for security for the year. This should be viewed simply as a timing hedge and not as a lack of confidence or conviction that a turnaround is underway. Don Allan will add more color on the guidance in just a few moments, and with that, I will now turn it over to him.

Don Allan - *Stanley Black & Decker Inc - SVP & CFO*

Thank you, Jim. Before I jump to guidance, I'd like to spend a little time and talk about our first quarter free cash flow performance. The free cash flow was consistent relatively with prior year, and we believe we are on track to deliver our $675 million of free cash flow, which is, as John mentioned, inclusive of $250 million of one-time payments that are primarily related to restructuring charges that we took in the fourth quarter of 2013.

So, a few items of note as we look at the free cash flow statement. First of all, our net income. You can see net income is up significantly year-over-year, and that's really where you see the impact of that convergence of GAAP versus adjusted EPS.

In the first quarter of 2013, we had one-time special charges of $81 million after tax, and here in the first quarter of 2014, that number was about $2.5 million. A significant decline in the charges to our P&L, as expected, and that convergence has begun and is moving in a very positive direction as we head through the rest of the year.

Working capital was a little bit worse than it was in the prior year, as you can see, as our working capital turns. From the seasonality perspective, always goes backwards from the fourth quarter to the first quarter. If you look at 2013, our working capital turns at the end of 2012 were about 7.5, and they went to 5.8 turns by the end of the first quarter of 2013.

This quarter we had a similar phenomenon, but a little bit more significant as we built some inventory in our CDIY business to make sure that we are adequately prepared for some Q2 and Q3 demands for our specific customers in certain regions. As a result, our working capital turns at the end of 2013 were 8.0 turns and at the end of the first quarter this year at 5.9. So, a little more significant of a retraction in that sequential momentum, as I discussed, primarily due to the seasonality for the CDIY business. But we still believe that we will exceed 8 working capital turns by the end of this year, and we are on track with our plans to make sure that occurs.

The other line has an unusual item in the last year, actually, in 2013 where we had a settlement or an outflow related to the sale of HHI that affected the cash flow statement which is one-time in nature that obviously didn't repeat again here in 2014. So, you see a $45 million benefit when you compare the two numbers year-over-year.

Then a positive as well in CapEx, whereas many of you know we made some significant investments in 2013 related to corporate growth initiatives but also related to certain integrations of acquisitions, and our CapEx levels were at a higher rate as a percentage of revenue. In 2013, that was 3.1% of revenue, and for a full year in 2013, it was 3.5%.

This year in the first quarter, it was 2.2%, right in line with our expectation and our full-year estimate of 2.5%. So, we are very pleased at the level of CapEx that we experienced here in the first quarter. Overall, on track with our expectations.

Let's move to guidance. As John mentioned, we are increasing the low end of our EPS range. Previous guidance was $5.30 up to $5.50. Is now $5.35 to $5.50, and we are also, as I just mentioned, reiterating our free cash flow guidance.

On a GAAP basis for EPS, we still have $25 million of expected one-time charges that will rate to ongoing acquisition integration that will occur this year. So, no change in that particular area.

What is the change in guidance? There's really two things that are driving it. The first is what Jim just mentioned about security margin and the expectation for dollars and rate. We now expect it to be relatively flat versus the prior year on a full-year basis versus the expectation of 150 basis point improvement we discussed in January. And Jim walked through it in a fair amount of detail what the drivers of that particular item are.

On the positive side, or what we would like to call a tailwind going related to some of our other businesses, more than offsetting the security situation, is a stronger performance in our industrial business is now expected, both on a volume basis and a profitability basis for the remainder of the year. And then we've also seen through many of the efforts around reducing our indirect cost across the Company, we saw significant benefit in the first quarter, and we would expect that trend to continue in various areas across the Company through the remainder of the year. That is more than offsetting the negative impact of adjusting the security margins, as I just discussed, and as a result, we are increasing the low end of our guidance range.

A few other items just to mention around guidance, as we look at the remainder of the year, just the staging of the quarters, over the last two years, 2012 and 2013, the first half is represented at approximately 45% of the full-year earnings, and we believe 2014 will be very similar. So, our first half of 2014 will approximate that 45%. Another item to note is that in the second quarter, we had a significant organic growth performance last year, which will result in a little bit of pressure on the comp and therefore, our organic growth will be slightly lower in the second quarter versus our full-year expectations of 4%.

Moving to the segments on the right side of the page, CDIY is relatively consistent with our January expectation. They had a solid performance in Q1, as you heard from Jeff. And we would expect the trends to continue as we go through the remainder of the year, mid single-digit organic growth rate and revenue and then the margin rate showing an increase year-over-year as expected.

The industrial business is going to be stronger, as I indicated. We expect now the organic revenue growth to be a little bit stronger than previously indicated back in January, and then the operating margin rate will expand a little bit more versus previous expectations as well. We've seen a really nice impact to the volume leverage as we've grown the business on the top line flowing through to the operating margin, as well as some really strong efforts around indirect cost reductions, as well as other people reductions that were in place in January of 2014. This is more than offsetting any pressure that we are seeing FX in the industrial segment.

And then security, Jim walked through in a fair amount of detail what the staging would be for the remainder of the year. But when you look at the organic revenue for the whole segment for the full year, we actually expect it to be either flat to a modest decrease, which is slightly lower than expectation back in January. Then I walked through the margin rate expectation a few minutes ago of a relatively flat performance.

Again, we do believe that we will see improvement in the second quarter versus the first quarter on a year-over-year comparison of operating margin. And then as we get into the back half of the year, we will begin to see some incremental OM growth in the security segment.

With that, I'd like to summarize the presentation portion of the call this morning. We delivered a very strong first quarter performance despite some North American weather issues and a very significant foreign exchange headwind, as you heard from us this morning. CDIY industrial delivered excellent results. Tight cost control focuses across our entire Company and embedded within our organization and allowed us to have some modest operating leverage here in the first quarter, even given $25 million of FX headwinds.

We remain very optimistic about our security recovery. However, Europe will be a little slower than expected, as Jim mentioned. We are very focused on our ability to continue to improve this business and move it forward and begin to see year-over-year profitability improvement in the back half of 2014.

As mentioned before, the focus for 2014 is to improve our near-term returns and our relative performance, and we believe we are doing many things to ensure that that happens. We're focused on our organic growth initiatives, which we saw the positive impact of that in the first quarter of about 2 points and our total organic growth of 4%. Our full-year expectation for organic growth is approximately 4% as well with the organic growth initiative contributing about half of that.

The security margin improvement is obviously a big focus, and Jim walked through a fair amount of detail on what we are trying to achieve in that particular area. We've been focused on surgical cost reductions to ensure our operating leverage, and you can see that starting to emerge here in the first quarter. And obviously, that strong focus above and beyond the headcount actions we took on indirect cost is really helping us achieve those objectives.

Working capital continues to be an area that we would drive improvement year-over-year. We do see the effects of the seasonality here in the first quarter. But again, we expect our working capital turns to be in excess of 8 by the end of the year.

And then certainly last but not least, our focus on capital allocation was rebalanced, as we mentioned back at the end of 2013. We are continuing our acquisition moratorium. We are prepared to do share repurchase when certain cash flows are available to do that and at the same time, we are deleveraging a little bit here in 2014.

We believe that 2014 is very much focused on executing both our operating and capital allocation actions I just mentioned, but at the same time, it's positioning our Company to deliver on our long-term financial objectives. With that, we will move to Q&A.

Greg Waybright - *Stanley Black & Decker Inc - VP, Investor & Government Relations*

Thanks, Don. Dawn, we can now open the call to Q&A, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Nigel Cole for Morgan Stanley.

Nigel Coe - *Morgan Stanley - Analyst*

Nice quarter, guys. I've got two questions. Firstly to Jim, you mentioned -- you highlighted the backlog trends in Europe, which are obviously very encouraging and then some of the challenges of converting that backlog, given the field office situation. Can you maybe talk about some of the challenges of converting that backlog and secondly, can you talk about the pricing that you are seeing and maybe the tight margins in that backlog? Thanks.

Jim Loree - *Stanley Black & Decker Inc - President & COO*

Sure. Let me take the -- we will call that a question and I have, or a subquestion, so we can answer both. But we are pretty confident in the profitability of the backlog, to your second question, because we have good visibility now into it. We know what the margin rates are in the backlog. That's something we couldn't have told you six months ago. There's been a lot of progress in that regard.

Now, there's still the issue of executing in accordance with what you think the margins are in the backlog, and we are getting a lot closer on that. I would say year ago we were probably averaging 4 to 5 points off, and we're much closer, within 2 points at this point in time, and we're continuing to converge that to try to be exactly on where we think we should be as it relates to what the margin log is in the backlog.

That goes to the primary question, which is some of the challenges that we face with respect to converting the backlog and how we're dealing with them. So, the way to think about this is that if we go back even just six months ago, what we had was 14 countries with about, roughly 70 regions within the countries and then a whole host of branches under them. Each one run autonomously with disparate information systems and really, no significant management process that was inherited with the Niscayah acquisition.

Even as -- so when questions were asked of management in the countries, or even in their regions, about what the state of the backlog was or how installations were going and what the efficiency was of what they were doing, there really was no accurate information. It was all hearsay and that type of thing. It was very loosey-goosey, and therefore lies some of the issue with respect to forecasting this business, historically. What we've done is in the last 90 days to 120 days, we have implemented a very, very rigorous set of metrics at the branch level that are now produced on a weekly basis, and we have set very specific targets for these metrics, and we expect the branch folks to deliver them.

These metrics can then be rolled up at the region level within the country, the country level and the total Europe level so we can see exactly what's going on with respect to things like labor efficiency, like net realized margins, which is what I was talking about in the beginning, and attachment rate for RMR, and so on. It is a dramatic change in the efficacy of what we're trying to do here, and its very similar to what we did in the North American business in the second half. The challenge now lies in, not so much in getting the information in putting the management process in, it now lies in making sure that the people that are actually held accountable are able to execute, and that's where the level of uncertainty lies now.

It is not necessarily in the profitability level in the backlog, because I think we have good visibility to that. It is much more in, okay, we've got hundreds of people in these branches that are expected to perform at a certain level, and are they really going to perform at that level, and how many of them are we going to have to replace? We could be far more specific about exactly what was going to happen in Europe with respect to margins if we knew that we had the right people in place in the branches. But this is the last shoe that we need to deal with, and I suspect there will be some attrition and so forth as we go through this process, but we are already making much more headway with respect to visibility, with respect to just the metrics in general and our ability to forecast the business.

Operator

Rich Kwas from Wells Fargo Securities.

Richard Kwas - *Wells Fargo Securities, LLC - Analyst*

I will have two questions, I'll make them brief. On security, I know -- I realize the approach here with derisking the full year in terms of margin expansion. But when we think about the next 12 to 18 months, should be see -- is the simply a push out? Or do you see potential greater magnitude of margin improvement in 2015 versus 2014, given the delay in the margin improvement this year? And then second question, Don, are these costs, in terms of you being surgical and being watching costs carefully, does any of that come back into the business later this year in 2015? Thanks.

Don Allan - *Stanley Black & Decker Inc - SVP & CFO*

On your first question, I think when we look at the security business, we still see long term, as a business, that can be mid teens profitability. We've communicated that before. The reality is that we do see a shift related to the European business by a quarter or two, as far as timing. Jim touched on it, it was more a timing issue.

I wouldn't necessarily expect that there would be a dramatic pop in profitability in 2015. I would expect that we continue to see sequential improvement and growth year over year in profitability in 2015. But I do believe, as Jim mentioned, there's a lot of things that we continue to be focused on in our European business, and these things will take time to continue to address. But overall, the profitability will continue to improve. But I would expect it to be more a gradual, linear type of improvement over the next two years.

On the indirect costs, when I look at that, that is really an effort of focusing on two things. One, volume of -- or usage, if you want to call it, it the sense of how often do people travel, when do they travel, are they being efficient about it, use of office supplies, et cetera. All these different things that are tied to professional individuals in the Company, that we've actually asked people to be more focused on the use of them and be more efficient and effective. And at the same time there's the pricing aspect of really driving more pricing benefit based on our contracts with certain vendors. Due to that, I actually believe these are permanent changes that will stay in our P&L and they will not be something that pops back and affects us at some either later quarter or later year. We're trying to attack this in a way that is driving permanent change and therefore, driving operating leverage and we are starting to see in our P&L.

John Lundgren - *Stanley Black & Decker Inc - Chairman & CEO*

Rich, let me just -- this is John. Let me just follow up.

We won't waste your spend time with some of the anecdotes. But to support what Don's saying, I think it is important to understand these are indirect costs. They're the kinds of things that John is talking about. These are the same conversations we've had with our board as every good board should ask. It's great that you are reducing indirect cost without having restructuring charges. What are we giving up? What aren't we doing?

I think it's really important to note the reductions aren't coming as we break SG&A and other indirect costs into seven buckets. They aren't coming into the two or three buckets that have a long-term impact on the business, specifically. We are not cutting R&D, we are not cutting product development, we are not cutting our brand building activities. We are being very careful to ensure that we get the ROI on any of those activities before we add to them. But these are all, quite frankly, in the administrative areas and areas, the cost of doing business that we all recognize, but we think Don and his team and the folks leading this project have done a really good job in differentiating what has an impact on the business on our brands versus what is spending, quote, cost of doing business that we could be doing business at a lower cost.

Jim Loree - *Stanley Black & Decker Inc - President & COO*

Said another way, we're going after waste, and examples would be like, for instance, these air cards that we have -- we use for hot spots, for Wi-Fi hot spots, historically. Well, you don't really need an air card anymore, because we have iPhones, and if you desperately need to get onto the Wi-Fi, you can use that. So, we have hundreds of air cards that we canceled, and we've canceled a lot of data services in areas where we -- where people had access to Wi-Fi. No need for that. As we go through each element of spending, there are just enormous opportunities to slash waste out of the system without affecting the ability of the individual to perform, and that's really the focus of this effort.

Don Allan - *Stanley Black & Decker Inc - SVP & CFO*

Which is really a natural evolution when you have a large merger such as we had with Stanley and Black & Decker and a few other large acquisitions on top of that. You put organizations together, people together, that settles down, they begin to work together. And then you focus on all the different types of costs that we are right now, which is really enforcing policy, changing policy and driving price.

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Operator

Michael Rehaut from JPMorgan.

Will Wong - *JPMorgan Chase & Co. - Analyst*

It's actually Will Wong on for Mike. Regarding emerging markets, you guys had about a 5% growth there this quarter. Just wondering how it stacked up relative to your expectations? And just more broadly, relative to the organic growth initiatives, emerging markets being the biggest driver of that [$50 million] of revenue growth the next couple of years. Just wondering, of those five pieces, how each is progressing to date and also relative to your expectations?

John Lundgren - *Stanley Black & Decker Inc - Chairman & CEO*

Yes, this is John. I will take it. You may or may not have been on the call during the source of growth discussion, and Jim can provide a little more granularity. We are about on track for emerging markets. Our growth is flat relative to the fourth quarter.

But there are, as you'd suggested, a tremendous amount of moving pieces. 85%, or 80% of our emerging market volume is either in Latin America or Asia. Latin America, we continue to the face political, socioeconomic and currency headwinds, and it varies dramatically by country. Tremendous currency headwinds in Brazil, inability to ship in Venezuela and Argentina for different reasons. And as a consequence, Latin America grew single-digits. That was below our expectations, but we absolutely believe, due to circumstances well beyond our control, on the other side, Asia continued to do well.

We tempered our expectations for Asia, as China is an example, the GDP in the 7% range versus low double-digits as it's been in the past. But we kept up or exceeded market growth in those particular areas. A tremendous amount of the organic growth initiative to which you referred is taking place in emerging markets, as Jeff pointed out in his presentation. We've got about 300 additional feet on the street, salespeople, commercial people, focusing on those markets. And we think that's a great investment in that those people are not as expensive as a salesperson in Europe or in the US, yet the revenue that each of them generates has the ability to be as great. So, we think of that as very high return on our business.

All-in, a tremendous -- a lot of moving pieces within emerging markets, but in general, at the end of the day, consistent with our expectations, given the tremendous headwinds we faced. And I just --Jim will do it if I didn't, give a shout out to our emerging markets team. If you think about the currency headwinds they faced, the political issues they faced in Argentina and Venezuela, as well as just softening markets in Asia or less robust markets, I should say, they did a terrific job delivering on their commitments to us and our commitments to the external world. This is a very experienced, capable team with highly capable, local executives in each and every market coordinating really well between our industrial and our CDIY businesses to ensure that we are getting our products to the markets, to the end users, to the customers, irrespective of the channel of distribution, which is much more grey, much less black-and-white than it is and developed markets. So, all-in, a long answer to a simple question, but there are a lot of moving pieces, and we are quite pleased with how well that team performed.

Operator

Saliq Khan, Imperial Capital.

Saliq Khan - *Imperial Capital - Analyst*

I'm speaking on behalf of Jeff Kessler. I had a two-part question for you. The first one is from a RMR standpoint. What type of trends that we seeing from North America? And from a broader perspective, as a look at the dichotomy between the types of success that you're seeing in North America versus Europe, versus the rest of the world, we see a shift in the focus on the regional level breakdown from a long-term perspective.

Jim Loree - *Stanley Black & Decker Inc - President & COO*

Sure. Yes, we will see a shift, because I would say we are far more capable in North America of delivering what I will call monitoring RMR versus service RMR, which has a higher gross margin and therefore, a higher operating margin. We -- as it relates to the portfolios, we had a slight increase in North America during the quarter. We had just a very, very slight decrease in Europe. It was actually very encouraging to see the stability of the RMR portfolio in Europe in the first quarter.

But the RMR portfolio in Europe tends to be more service-based than it is monitoring. The challenge for us strategically here, because we do have the monitoring capacity in Europe, is to drive RMR monitoring sales increases. I alluded to in my comments, a few things that we are doing to be more proactive about driving RMR sales in Europe by changing the comp plans, which has been done, by focusing the sales force more on that, by focusing on RMR attachment in our metrics when we look at the sales and orders. All that stuff over the long term will help us shift the mix from the service RMR, which is good. It's better than installation, but it's far from the profitability level of the monitoring RMR.

Operator

Michael Dahl from Credit Suisse.

Michael Dahl - *Credit Suisse - Analyst*

I wanted to ask about the CDIY business, particularly, with Jeff here today. First on the PPT growth was pretty impressive and well in excess of the other SBUs. Can you talk specifically what you think was driving that? Was it outsized product launches in DeWalt or anything there? Then, just second, a quick clarification on the inventory comment. It sounds like that was unintentional build, and so just wondering if that was related to a specific promotion or product launch?

Jeff Ansell - *Stanley Black & Decker Inc - SVP & Group Executive of Construction and DIY*

Yes. Michael, this is Jeff. To respond to the question, the PPT growth led all four of the SBUs for the fourth consecutive quarter. We continue to grow that business concurrent with the rest of the business but at accretive levels. And really, the driving force behind that is two things. Protecting the core business with things like innovations within brushless, cordless, et cetera.

Things that are driving higher average tickets within our core and then augmenting that with the expansion products that fall into adjacencies that are predominantly incremental. Things like cordless nailing, cordless grease guns, heated jackets, things that we hadn't done historically that provide us new revenue opportunities to serve the same end use customer channel. That's really why that has -- that business has performed at an accretive level, and new product development is clearly the driving force there and will be for the foreseeable future. I spend a high percentage of my time working on the pipeline of new product development with the teams, and if you could see my now, I'm smiling quite robustly. It looks quite good.

In terms of inventories, we have intentionally put inventory into the system for two reasons. One is, even with headwinds of weather that existed in the first quarter, we had positive POS. We are not exactly certain what happens from a global perspective as the US thaws and other things continue to advance. The thing we are not going to do is starve our growth. We have the opportunity over three quarters to work through that inventory and if, in fact, there is more demand, we want to be able to serve it. It's not atypical. We do this typically in every first quarter. We've done it at an accelerated level because our growth is also going to accelerate.

John Lundgren - *Stanley Black & Decker Inc - Chairman & CEO*

This is John. I will just add, because you won't get a follow-up, Jeff and his team have a 10-year track record, that's my history. Jeff's is a little longer than mine, of doing exactly what Jeff said.

SFS was, if you will, born and embedded in the CDIY business. Jeff and his head of operations, there's no one in this Company that understands the benefits, both in terms of cash flow and productivity to high working capital turns, getting the -- having supply and demand match, rigorous S&OP process. Of things that I worry about, and there are many, CDIY getting -- making sure inventory is in line as the year progresses and driving the continuously improved working capital turns for which they've got an incredible track record, I've got a high degree of confidence that that will continue.

Operator

Mike Wood from Macquarie.

Mike Wood - *Macquarie Research - Analyst*

Good job with the 31% ex-currency incrementals in CDIY. I'm curious if you can comment if you think you could sustain that level, or if the quarter had the distortions from, say, better efficiency from that inventory build that you just talked about or any delayed promotions around the timing of the spring selling season. Thank you.

Don Allan - *Stanley Black & Decker Inc - SVP & CFO*

First of all, when we do inventory builds in the first quarter, or any quarter, for that matter, you don't really get the benefit in your P&L until you sell the product to your customers. Because the way the accounting works, you have to basically -- any positive variance, or any variance related to that, gets put on your balance sheet, and then it will flow through as your cost of sales when you sell to your customers. There is certainly no impact in the first quarter related to that aspect of it.

As far as the FX impact, we did mention there was a $20 million impact to CDIY, which obviously prevented us seeing operating leverage. But when you excluded the impact, you did have that operating leverage. As time goes on here, assuming there's no change in currency rates, the number's going to get a little smaller, just a little bit smaller in the second quarter, but it will still be significant. And in the back half, there will be a still a little bit of negative FX pressure, but it will be at a much smaller pace. And then you will really start to see the operating leverage flow through at that point in time.

Operator

Winnie Clark, UBS.

Winnie Clark - *UBS - Analyst*

Can you talk about how business trended in your North Americas security business over the course of the quarter? And did business improve meaningfully in March following weather headwinds earlier in the quarter? And then you also continue to see good momentum from your security vertical initiatives. Curious if you are seeing any competitive response at this point.

John Lundgren - *Stanley Black & Decker Inc - Chairman & CEO*

Okay, so yes, we did see positive development throughout the quarter. January and February weather were -- we had branch closings that really exceeded any days of branch closings that anybody here -- since we can remember since we've owned securities, which is about 10 years, over 10 years. So, it was really rough from that perspective. I don't want to overstate the impact, it could've been 1 point of revenue or something like that, that -- maybe 2 at most that is derived from that. However, there was definitely a positive trend, as the quarter went on.

The vertical initiatives in healthcare and in education and retail, I'd say are the ones we're making the most progress on, especially retail and healthcare. The wins really, I think are just beginning to get our competitors' attention. Most of what we are doing in those areas, we're doing with proprietary differentiated technology, which is really going to be difficult in the very, very short term to compete against in the types of bake offs that we are having.

But we expect competitor response at some point, that would be natural and normal. It will be the ones, the bigger companies that can muster a competitive response with technological solutions. I think we all know who those are. We have some that -- we have a very big one and we have several that are more vertical focused. You have one that competes heavily in financial services, one that competes heavily in retail, and they are all doing their own thing. But we haven't seen anything directly related to our activities yet.

Operator

Jeff Sprague from Vertical Research.

Jeff Sprague - *Vertical Research - Analyst*

I just wanted to come back around to cash flow. Jeff addressed what he's doing on working capital and inventory in his business. But where are the leverage points for the year? What I'm thinking about, is there any scope to reduce the $250 million as you execute through the year? Working capital in the emerging markets as you work that, opportunities on payables. Wondering if the bias to your cash flow this year is potentially to the upside or the downside? Thank you.

Don Allan - *Stanley Black & Decker Inc - SVP & CFO*

I will take that question. I feel really good about where we are with the $675 million. I do think that, like every year, we start out with a large, as I mentioned, working capital negative. The vast majority of that is planned and has been the case for the last three or four years.

And then we have the specific actions that we are taking, not only in inventory, but all the other areas of working capital as we progress throughout the year. Of course, there's a big seasonality impact in the fourth quarter that goes the other way, as we see a lot of the revenue in our CDIY business in the month of October and November. And then it slows dramatically in the month of December, which allows us to really collect a lot of receivables, reduce our inventory levels, et cetera. All those dynamics together really drive our confidence and our ability to exceed 8 working capital turns this particular year.

As far as other items on the cash flow, we are controlling CapEx, as I mentioned. We want that to be 2.5% of revenue, which is roughly $300 million for the year. We think we are tracking to that. We don't want to starve the CapEx to the point where we cause issues related to revenue or other areas in our business such as productivity projects and our supply chain. But we think we are at the right level with $300 million. And then the one-time payments of $250 million, I think that's a very reasonable balance estimate at this point. I'm certainly not concerned about it being above that number. With anything, it does have the potential to be slightly below it.

Operator

David MacGregor from Longbow Research.

David MacGregor - *Longbow Research - Analyst*

Question for Jeff on CDIY. I noted that your pricing was down about 1%, and I'm mindful that this might be a mix driven, just giving everything you are doing in the emerging markets. But I'm just wondering if you could talk about all the innovation that you seem to be delivering to market right now and your ability to price that innovation just given competitive developments.

Jeff Ansell - *Stanley Black & Decker Inc - SVP & Group Executive of Construction and DIY*

Yes, certainly. The emerging markets platform, 1,000 new products that we outlined, most of which began launching already this year, it does put downward pressure on the absolute price, given that it's MPP versus HPP. That said, we've found a way most recently through -- via the acquisition of GQ and the work we've done in those markets to make sure that we are profitable at those price points. While we serve a different market and different price point, we also continue to be squarely profitable in that.

The one thing that I would say also in the quarter is we did have benefits from some promotional activity in the first quarter of this year that we didn't have last year, if you recall. We didn't throw out a lot of products. We did have some promotional activity that helped us deliver 6% growth. That said, clearly inside the P&L, operating leverage excluding the currency headwind. All things played together quite well. We don't see a dynamically or dramatically different pricing environment that we had in the previous quarter or the previous several quarters, I would say.

Operator

Our last question comes from Liam Burke from Janney Capital Markets.

Liam Burke - *Janney Montgomery Scott - Analyst*

Jim, you had a fair amount of success or fair amount of history developing the emerging markets in Latin America. As you continue to grow in Asia Pacific, are those markets developing faster or slower or pretty much the same as you experienced in Latin America?

Jim Loree - *Stanley Black & Decker Inc - President & COO*

I think when we grew in Latin America, we were in a period when Latin America was on fire, so to speak, in a good way, with positive FX, positive economic growth. Some euphoria in Brazil, lack of government intervention in places that we are getting it now and so forth. What we've seen is in some ways, the Latin American market has either matured in some cases, or in other areas, has gone into a volatility stage that John was referring to earlier. So, not a classic development of the market.

I think what we see in Asia is that starting with China, you almost have to take them one at a time. China, as everybody knows, for a long time was in the 9% to 10% growth mode, and the growth in China has slipped to maybe 7%, according to the government, maybe less according to what we see. But we still see strong out performance, double-digit growth in China. And the combination of having the hand tools and the power tools, having the MPP and the HPP, great distributional that we have, now moving to interior China with our distribution channels and so forth. I think all of that enables us to have the same kind of development rate that we had in the halcyon days of the development of the Latin American market.

India, we don't have a big presence there, and it's just a big question mark as to where India is going, and a lot depends on the election that's going to occur here shortly. In fact, I would just mention that in the emerging markets in general this year, about 60% of the countries are undergoing electoral processes, which creates near-term instability and uncertainty. But -- so some of these -- the answer to this question is a little bit more medium term I'd say, than long term.

Southeast Asia, we see to be a really strong growth area for many years to come. Indonesia, in particular, I think is going to be very, very strong. Thailand, if it could ever get through its political challenges, could be very strong, as well. The Philippines will -- is gaining momentum as we speak. I think we are pretty bullish on Southeast Asia in general.

Then, as we move over to some of the other regions like the Middle East, it's always a bit of a crapshoot as to what's going to happen there geopolitically. And then Russia and Turkey, big question marks. I think in general, to sum it up, I'd say we are just seeing a lot of volatility. It's not quite clear where the growth is going to be the strongest in any given point in time, or where it's going to be the weakest.

Our approach has been place our bets cautiously and conservatively in the areas that we feel are the best places to be, but don't eliminate presence in other areas, because there, you just don't know. So, that's been the approach, and I think we're going to see excellent growth from the emerging markets for years to come. I think we have a nice, strong, I won't call it a head start because I think some of our other competitors got a head start on us. But we are working on a leapfrog at this point in time strategy.

John Lundgren - *Stanley Black & Decker Inc - Chairman & CEO*

Liam, the only thing to add to that, I think that's an incredibly good summary of a huge number of geographies with a lot of moving pieces. I believe -- I know you are aware of this, but just to remind you, you mentioned Latin America in general. A lot of the early growth in addition to the environment being incredibly robust, as Jim suggested, were Stanley Black & Decker synergies. If you just take the two big regions, or if you take all the other emerging markets, Asia, Eastern Europe, Middle East, Stanley and Black & Decker has similarly-sized businesses, we were both underdeveloped. The opportunity to grow was there, and we've invested in that, as Jim suggested.

Black & Decker had a meaningful business in Latin America, Stanley did not. A tremendous amount of the early growth in Latin America were, quite frankly, what we've categorized as revenue synergies. Selling legacy Stanley products through well-established Black & Decker channels of distribution, even producing hand tools in our formerly Black & Decker plant in Uberaba, Brazil, that gave us a nice jumpstart to growing in Latin America. Just to add to what Jim said, which is, I think, pretty clear.

Operator

Thank you. I will now turn the call back to Greg Waybright for closing remarks.

Greg Waybright - *Stanley Black & Decker Inc - VP, Investor & Government Relations*

Dawn, thank you. We'd like to thank everyone again for phoning in this morning and for your participation, and obviously, please contact me if you have any further questions. Thank you.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.
