FINAL TRANSCRIPT

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PRESENTATION

Operator

At this time, I would like to welcome everyone to the Stanley Works' first quarter results conference call. All lines have been placed on mute to prevent any background noise. After the speakers remarks there will be a question and answer session. (OPERATOR INSTRUCTIONS). Thank you, I would now like to turn the call over to your host, Mr. John Lundgren Stanley Works' Chairman and CEO. Sir, you may begin your conference.

John Lundgren - *The Stanley Works - Chairman, CEO*

Thanks, Sierra, good morning. Just before the cautionary statements and proceeding with this morning's call, we have a brief announcement regarding Investor Relations at Stanley, which you may have seen this morning. Gerry Gould who is Stanley's Vice President of Investor Relations and has been for the last 11 years has accepted a position as the Vice President of Investor Relations for RSC Equipment Rentals in Scottsdale, Arizona. And simply we want to thank Gerry for obviously his many years of diligent service and valuable contributions to the company. Of course, we wish him well. We know he'll enjoy the sun and do a really good job for RSC and with us today is Greg Waybright, who is our Vice President of Internal Audit, and Greg will also be serving as our interim Vice President of Investor Relations as we complete a search for Gerry's placement. Greg, I'll turn it over to you for the cautionary statements.

Greg Waybright - *The Stanley Works - Interim VP - IR*

Great, thanks, John, and Good morning to everyone. On the call in addition to myself and John Lundgren, our Chairman and CEO is Jim Loree, our Executive VP and CFO as well as Gerry Gould. There are a few recent press releases that I'd like to mention. One relates to our first quarter results, which was issued early this morning and the others relate to our second quarter dividend declaration and the results of our annual shareowners meeting which were issued yesterday and these press releases are available on our website. Today's presentation is also available on our site and that's important as we will refer to these charts during the call. John will review Stanley's first quarter results, followed by a Q&A session.

The call is expected as usual to last approximately one hour, and a replay of the call will be available beginning at 2:00 today through Wednesday, April 30th. The replay number is 800-642-1687 and the access code is 42633122. And you can also call me with any questions, my number is 860-827-3544. And I look forward to speaking with some of you as part of my interim investor relations role at Stanley.

Two quick announcements before we proceed with John's comments. Both reminders, one being that we issue and/or update our earnings guidance on an annual basis. In our press release at the beginning of each quarter and we cannot comment on such guidance thereafter. If the guidance does change materially, we will issue a press release and conduct a conference call and secondly, the obligatory cautionary statement language, being that certain statements made during today's discussion by the various Stanley participants are forward-looking statements. They are based on assumptions of future events that may not prove to be accurate, as such they involve risk and uncertainties. Actual results may differ materially from those expected or implied so we direct you to the cautionary statements in form 8-K which we filed with today's Press Release and recent 34 act filings. I'll now turn the call over to John Lundgren.

John Lundgren - *The Stanley Works - Chairman, CEO*

Thanks, Greg. I'm going to go through a brief and call it formal presentation of the results. Jim and I often share this. Jim is here with us today. It's relatively short, so I'll take us through the entire presentation, to allow us plenty of time for questions and answers.

In summarizing the first quarter business highlights, 6% earnings growth which led to 85% earnings per share despite the difficult market conditions, particularly in the North American residential construction business. Revenues were up 3%. Certainly they were aided by foreign currency translation and acquisitions, which did more than offset the softness in organic volume. We grew our gross margin by 60 basis points as a percentage of revenues. As our productivity programs in the plants and good work in the marketplace on price realization more than offset the inflation. Excellent quarter in terms of cash flow of $83 million, up 22% over the first quarter of '07. As you would expect, the CDIY revenue was flat, as the currency offsets in foreign markets compensated for the weakness in demand in North America. In the Industrial segment, both profits and revenues were up 8%, we'll talk more about that in our segment detail, and an outstanding quarter in security with profits up 17% on revenue growth of 3%. Again, more detail on that in the segments.

So looking quickly at the first quarter results in total, we see net earnings flat at $68 million, which translated to EPS of $0.85. Interest expense tax rates, share count, tax rate 70 basis points lower than the same period year ago, all contributed to the increase in earnings, so 6% earnings growth despite relatively difficult North American market conditions. Looking a little more closely at revenues and the sources of growth. As previously stated, revenue's up 3%. Unit volume across the globe was down 5%, offset by 2% price realization, which led to the previously-stated minus 3% organic growth. We had a 4% lift from currency, as you know, about 45% of Stanley's revenues are outside North America and another 2% from the annualized effective acquisitions that weren't part of our portfolio in the first quarter of last year, leading to the revenue growth of about 3%.

By segment, and we will get into more detail on this. CDIY as previously stated was flat, organic growth on a global basis was minus 5%. And as I stated earlier, currency and price offset the unit volume softness which was overwhelming concentrated in North America. The Industrial segment grew 8% in total, was down 1% organically, a lot of moving pieces there but Europe was strong. Our engineered solutions business was strong ,and of course we were helped by foreign exchange, offset by weakness in North American automotive and repair segment and a lot of things driving that, and we'll talk about that more in the segment detail. Two small acquisitions both notable of which was Innerspace contributed in addition to the FX to the total growth. Last, but certainly not least, security, which was up 3% in total, down 2% organically, but that's a tremendous achievement and I'll talk about it more in the segment when you think about the fact that we offset a 4 to 5% headwind due to the loss of a major customer in North America, which was announced this time last year but the volume didn't disappear from our P&L until the middle of the third quarter. So, as you see, 3% organic growth in the total securities segment, excluding hardware.

Let's look briefly at the three segments starting with construction and DIY. As I say, flat revenues and those as in both the consumer totals and storage and our business were basically flat. Segment profit down 19% in absolute terms and 280 basis points. The U.S. continues to be adversely impacted by the residential construction market. That, of course, affects consumer tools and storage as well as Bostitch in North America. Those businesses were both down low single digits in terms of revenue. Sales in the rest of the world were up 6%. A lot of that was foreign currency. Europe, up about 7% in the consumer tools and storage business and Bostitch up even more that in Europe, so relatively good performance outside the U.S. The profit rate is negatively impacted as we failed to fully recover inflation, about $20 million of annualized inflation came at us in February, and we absorbed some of that in the cost line and didn't yet recover it with price and productivity.

The soft volume resulted in lower absorption of fixed costs, and we did continue to spend in market development. We made our commitment early in the year to continue to support our brand in consumer tools and storage as well as fully implement and retain our discovery team activities and if appropriate, as suggested in our guidance, we'll reduce those slightly to preserve earnings later in the year but that money was committed. We thought it was money well spent and we continue to believe it will strengthen us for the future going forward. Just a brief note, we talked earlier about anti-dumping tariffs and the impact it had on our Bostitch business. In the short-term, it's neutral. Neither positive or negative and in the long-term we think it's an advantage for Bostitch.

You may recall in January of 2008, tariffs that ranged between 4% and 118% were imposed on all imports from China as a result of a lot of study and fact that the conclusion that certain fastening products were being dumped in the U.S. at unfair prices. The total impact on Bostitch was 19%, which was well below a lot of the competition and it, of course, just reflected the product mix of Bostitch and going forward, it will level the playing field against any relative to Chinese imports that were being dumped. Short-term, any of the increases have been passed along in terms of pricing because it's effecting everyone, long-term we think it's an advantage for Bostitch and that Bostitch has very capable production facilities in North America as well as in Poland, as well as in China near Beijing. Good production on three continents gives us the flexibility to move production going forward as exchange rates and market conditions vary.

Looking at the Industrial segment, as I said, revenues and segment profit both up 8%. Profit rate was flot. Industrial tools and automotive repair tool revenues were up 6%, down 2% organically. Facom continues to perform well. And our U.S. industrial revenues were down slightly, that's driven primarily by weak automotive sector assembly and Mac both down and we'll talk about those in the Q&A to the extent there's interest. Our engineered solutions business was up 18%, 3% organically. Our Vidmar business remains very strong. Total storage grew 50%. 13% excluding acquisitions and in total, segment profit was up 8% despite the lack of organic growth. The rate was flat, we did well with pricing and productivity, and that offset any of the negatives associated with inflation and mix.

A lot going on in the security segment. Profit up 17% on 3% revenue growth and the rate up nearly 200 basis points. As previously stated, the 3% revenue growth for the total segment would have been in the neighborhood of 9% excluding hardware. Segment profit, as I say, remains strong, up 17%, looking at our sub segments within security, Convergent had a very good quarter, 12% sales growth, 2% of which was organic. The difference between those two are a combination of a full quarter of HSM, where we brought that business on in mid January a year ago as well as foreign exchange, about 20% of that business is generated in the UK. So that's the primary differences and of course some good pricing work between organic and total. Restoration of organic growth in the U.S. systems and integration business was a very encouraging aspect of the quarter. As the HSM acquisition and the reverse integration that we talked about on previous calls, that's taking impact and it was good to to see what we call the Legacy Convergent Security Solutions business performing well and showing true organic growth.

On the mechanical side, revenue was down 3% as do overwhelmingly or more than 100% due to the hardware issue that I talked about before. Plus 7%, 4% of which was organic if we exclude hardware and the profit increase was driven by a combination of organic growth, price, and the benefits of the HSM integration in convergent that we talked about previously. Good story on working capital, which continues to contribute to a good story on free cash flow. Specifically, looking at the elements, despite the softness in demand, we took five days out of inventory and reduced our inventory in absolute terms. Receivables were up five days or 11%. That's overwhelmingly due to European mix with a higher percentage of our revenue in Europe, foreign exchange, and as many of you are aware in general terms -- negotiated terms are a lot longer in Europe than they are in the U.S. So the mix towards more European business in the first quarter this year versus last year is having an impact on receivables. Payables, again, nice improvement in payables but I want to just emphasize I feel it necessary to emphasize that it is due to negotiation of terms with various suppliers, which is an advantage of our strong balance sheet and not withholding payments.

We're upper grade investment level credit. We want to stay that way and it's simply due to better terms with some of our strategic suppliers and renegotiation of those terms, and as a consequence turns improved from 4.4 to 4.6 as inventory and payables performance more than offset the increase in receivables. Cash flow was up $15 million in absolute terms and as previously stated up 22%. Fairly straight forward in terms of where it came from. The biggest contributor was just better management of working capital. We believe we're still on track to achieve our $500 million of free cash flow for the year and that, of course, is what is going to allow us to continue to pay the dividend, make acquisitions, and pursue opportunistic buybacks as necessary as required. And it results in our balance sheet staying pretty strong and as I say the capacity to allocate our capital consistent with previously-stated strategies and priorities.

Last, but certainly not least is guidance. You look at 2007 EPS of $4 a share, which was up 15% versus '06 on $457 million of cash flow. Current guidance of $4.20 to $4.40 and $500 million of cash flow, this was outlined, we think as clearly as we could outline it with what we know today in the Press Release, but our first quarter EPS was consistent with the fiscal year of 2008 guidance of $4.20 to $4.40, second quarter recessionary operating environment also was what we anticipated at the beginning of the year and the end of last year when we issued our guidance. Our guidance assumed two quarters of organic revenue contraction, and that was consistent with our stated belief in a mild to short-lived U.S. recession. As a consequence, the second half economic conditions will need to stabilize in order to support the achievement of our full year guidance of $4.20 to $4.40. In the event it doesn't, contingency plans, primary in the form of cost and discretionary spending programs secondly in the form of pricing are being developed or in fact are in place to protect earnings above prior year levels, if in fact the weak demand continues, and based on what we've seen today and the good achievement focus on working capital management, we believe that our $500 million estimate for free cash flow for the year is well within reach.

At this point, I would like to turn it back over to Sierra, and Jim and I will try to respond to any of the questions you might have.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS0. We'll pause for a moment to compile the Q&A roster. Your first question comes from the line of Eric Bosshard with Cleveland Research Company.

Eric Bosshard - *Cleveland Research - Analyst*

Thank you, good morning,.

John Lundgren - *The Stanley Works - Chairman, CEO*

Good morning, Eric.

Eric Bosshard - *Cleveland Research - Analyst*

I guess a couple of things. One, can you give us an update on where we're in the Bostitch improvement effort and even perhaps the portfolio evaluation consideration with that business as well.

John Lundgren - *The Stanley Works - Chairman, CEO*

I'll take that one. Want to be sure you get your followup in Eric, Bostitch is, I would say on a long-term basis continuing to progress as we would hope to would. It's fourth and first quarter, we're a bump in the road relative to the nice sequential improvement we've seen for four quarters running before it. But there's so much confusion in the marketplace over 19% price increases across the board, what's that doing to volume on a short-term basis it's really difficult to be very granular on how much of any volume softness was due to the marketplace due to price increases. How much due to head wind so it's fairly difficult to get, for us or anyone else, on a short-term basis to get a handle on the Bostitch top line.

Strategically, the manufacturing restructuring and our foot print modification is behind us and we're quite pleased with the results, as I've alluded to earlier, we've got a world class manufacturing facility in Long Fong, China. We have great facility in southern Poland as well as a very capable facility in East Greenwich, Rhode Island and we've closed a facility that by no fault of its own was not cost competitive in terms of delivered cost in Chihuahua Mexico. We've actually moved nail production from China back to the U.S. as a result of about 10% of our production, the combination of labor rates, tariffs and rememby strength has made it prudent for us to move about 10% of our production and 100 jobs with it back to the U.S. on the fastening side.

On the tool side, we are producing tools in the Besco plants in both Taiwan and China. That is on or slightly ahead of schedule so we feel good there. So I guess to sum it up, from the internal perspective, we're pleased with where we are to the extent that it faces marketplace challenges both in terms of the confusion around tariffs and North American headwind in terms of construction, time will tell. You mentioned portfolio evaluation, we've been very clear about this for a long time. Bostitch is making money. I think sometimes people assume it isn't, but it's low single digit operating margins. It's been 10 or 12%, it needs to get back there within a six to 12 month period, which will be two years after we started the restructuring program or it's less likely to be a part of our portfolio in that we simply don't continue to support businesses that are not creating shareholder value. Right now it's not destroying shareholder value, and I think the team's doing an outstanding job with what they can control and got some pretty serious marketplace headwinds, and we're trying to see if we can offset those going forward.

Eric Bosshard - *Cleveland Research - Analyst*

Secondly, it seems like you've got a contingency plan that you've identified to ensure that you can have, I guess at least up earnings if demand continues to get worse and I guess my question is what does that consist of and why not just do it rather than wait to see what happens with the market.

John Lundgren - *The Stanley Works - Chairman, CEO*

We've done some. I'm goat let Jim give you as much insight as we're comfortable doing on this call. If I inferred we are waiting I misspoke or didn't communicate clearly enough. Two tranches, and Jim will take you through a little bit of that.

Jim Loree - *The Stanley Works - CFO*

Anytime you have a contingency plan that's going to generate enough earnings to be significant it's going to involve reductions in force and obviously we take those very seriously and we only do those when we feel it's appropriate to do them and there's tradeoffs between the long-term and short-term that you invariably must make when you do those, so our preference would be to not do anything in terms of the contingency plan but the economic realities are out there. As John said, we've done the non-people related part of it today so that's already in progress. The way we're looking at is it will cost us, if we do what we're doing, it will cost us about $0.20 a share in restructuring and probably provide a benefit of about $0.40 a share so for plus $0.20 a share to offset the lower volume in the second half that we might have if the economy doesn't come around, we're just making a decision as to whether we want to do that or not based on the long-term/short-term tradeoffs.

Eric Bosshard - *Cleveland Research - Analyst*

And the net saves Jim would be $0.20 in the second half is how the math looks like it would shake out?

Jim Loree - *The Stanley Works - CFO*

Yes, the volume we assumed in the original guidance, if we were to continue to experience the kinds of issues that we're having, the volume would be about a $0.50 issue for us and we would get a net of about $0.20, which would be about $0.30. Now that's assuming we had minus 3%. I'm talking organic growth at this point. We incurred about minus 3%, or experienced about minus 3% organic growth in the first quarter. Our outlook for the second quarter is fairly consistent with that. As we look into the second half and we don't see any improvement, we're looking at about a $0.50 issue vis-a-vis the original guidance.

Operator

Your next question from Jim Lucas with Janney Montgomery Scott.

Jim Lucas - *Janney Montgomery Scott - Analyst*

Good morning, guys. Two housekeeping and one strategic question. With regards to the hardware comp, when does that anniversary -- that's the first one.

John Lundgren - *The Stanley Works - Chairman, CEO*

On okay, let's tackle that and then we'll go to your other question or questions. The hardware in total will cost us about $50 million, about 40 of which will be experienced this year. The first three quarters of the year are the time in which that will be recognized. So we're talking about 12 to $15 million a quarter depending on the quarter for the first three quarters.

Jim Lucas - *Janney Montgomery Scott - Analyst*

Okay. And with regards to the buyback. I don't know if I missed this number or if you gave it out or not. How much did you buyback in the the first quarter and how much is left under the current authorization?

John Lundgren - *The Stanley Works - Chairman, CEO*

We bought back 2.2 million shares in January at $46 a share, that came on the heels a $3.6 million share buyback and it was about an $8 million, 7.8. So about an $8 million authorization and we expended 2.2 of it.

Jim Lucas - *Janney Montgomery Scott - Analyst*

So there was nothing done after January?

Jim Loree - *The Stanley Works - CFO*

No.

Jim Lucas - *Janney Montgomery Scott - Analyst*

Finally, with regards to Europe, can you give us a comment of what you're seeing there, both from Facom and your other industrial businesses and the consumer businesses with regard to both of those?

Jim Loree - *The Stanley Works - CFO*

Yes, we were listening to Black & Decker's call and I think that they mentioned that they were having a little bit of a slowdown in Europe in the Construction and DIY markets and I would say that our experience is reasonably consistent with that. It's a lit of a slowdown but it's not any kind of a deep dive like we're seeing in the U.S. CDIY markets. Industrial, we're still growing in Facom, organically, not the same kind of torrid rate we were going in the last half of last year, but still growing, so I think that what we have in Europe is a situation where the overall U.S. economy impact and the currency strength and everything else is providing a little bit of a throttle on their growth but it's not tanking in any respect.

Jim Lucas - *Janney Montgomery Scott - Analyst*

Okay. Thank you.

Operator

Your next question comes from the line of Michael Rehaut with JPMorgan.

Michael Rehaut - *JPMorgan - Analyst*

Thanks, good morning.

John Lundgren - *The Stanley Works - Chairman, CEO*

Good morning.

Jim Loree - *The Stanley Works - CFO*

Hey, Mike.

Michael Rehaut - *JPMorgan - Analyst*

First question I guess just goes to the raw material impact you had mentioned last quarter that you were expecting about a $75 million from inflation and recovering about 80% of that, can you give us an update on how those numbers worked now and also what that recovery or incremental positive might be with some of those incremental cost reduction efforts in place? I guess it's more head count related but nonetheless.

Jim Loree - *The Stanley Works - CFO*

I already talked about the cost reduction efforts in terms of the impact which I'll just repeat for ease of administration here. It looks like it would be about a $0.40 improvement in the second half, which would be annualized around $0.80, and the restructuring associated with that would be about $0.20, of which it's likely that $0.10 or so would be incurred in the second quarter if we decide to do this. So, the net benefit of the restructuring -- or the cost actions would be about $0.20 and it would be in the second half.

Michael Rehaut - *JPMorgan - Analyst*

And then $0.40 incremental in '09?

Jim Loree - *The Stanley Works - CFO*

If that were to carryover absolutely.

Michael Rehaut - *JPMorgan - Analyst*

Because of the annualization.

Jim Loree - *The Stanley Works - CFO*

Correct and then your other question was relative to the price inflation. I'm very pleased with our situation here. Not the fact that we're getting more inflation but the fact we responded I think very well -- as soon as the next wave of inflation came in the first quarter, our operating heads jumped on it and implemented price increases and so we actually have good news to report here. Now the inflation estimate for the year is up to $100 million. So it's up $25 million but the recovery percent is up to 90%.

Michael Rehaut - *JPMorgan - Analyst*

That's great. That's really great reaction and proactivity. The second question is just on the commercial, your expectations for commercial end markets. Obviously, on the consumer and macro side, things are slowing, but up until now, commercial end markets have been relatively stable if not growing year-over-year, but the back half, there's a lot of people out there looking for a significant slowdown. So I was just wondering if you could provide any idea of how your guidance, either the $4.20 to $4.40 range, or the more pared back type of expectations you're trying to set if things soften on a macro level, but within that, what is your outlook for commercial and may be just kind of remind us where that impacts you -- on a segment basis where that impacts your business.

Jim Loree - *The Stanley Works - CFO*

Well, it's about 10% of the company and actually it's less than 10%. About 8% of the company, about $400 million in revenue, and it is largely in the securities segment. Obviously some in the construction and DIY but very little. Most of it is in the securities segment. The guidance that we issued and we discussed this in a little bit of depth at the analysts meeting is that we didn't really have anything specific on commercial but we said that it would be slowing. We expected it to slow in the second half of the year because of the credit issues that are being experienced at the moment, and that we didn't expect it to go severely negative. So, I would suggest in this kind of contingency view, if you will, that we're thinking about here for the back half of the year, I would expect that we would anticipate issues in the commercial construction market. Beyond what we had in the the original guidance.

Michael Rehaut - *JPMorgan - Analyst*

Thanks, Jim. One last question, if I could. The free cash flow obviously comes in -- is still coming in nicely and you still have good confidence there. Relative to your --

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John Lundgren - *The Stanley Works - Chairman, CEO*

Sorry, Mike, go ahead. Did we lose him?

Jim Loree - *The Stanley Works - CFO*

We lost him. Let's have the operator put him back on, if we can. He'll have to dial back in.

John Lundgren - *The Stanley Works - Chairman, CEO*

Why don't we take another call. Yes, let's take another call and while we're doing that maybe we can get him lined up to finish his question. Thank you.

Operator

Mike, your line is open.

Michael Rehaut - *JPMorgan - Analyst*

Thanks, I appreciate that guys. It was just relating to the free cash flow projections and your use of that cash. If you could give us an idea, particularly on the acquisition front, how you see that market right now, if there are any more pressing or compelling opportunities relative to 6 or 12 months ago either in terms of price or segment or geography?

Jim Loree - *The Stanley Works - CFO*

Yes, I'll take that, Mike. The good news is the cash flow gives us the opportunity to continue to pursue our strategy and after we pay our dividend, I think we've been very clear strategic accretive acquisitions to clear our financial hurdles are a top priority, and that being said Stanley's on sale right now, and we obviously look at it very carefully relative to acquisitions even though they'll advance our strategy. Our pipeline has never been more full, to be specific, in terms of your question. There's a lot out there, particularly in Europe, both in the securities space as well as in the industrial tool space, which the growth platforms where we focused. It won't surprise you or anyone to know that fewer financial sponsors show up in auctions or processes or even in an attempted unilateral negotiations. That being said, there's been little or no price capitulation so far and it's a long way of saying both in the tool space and in the securities space, good properties are selling for multiples of recurring monthly revenues, multiples of EBITDA, et cetera, that haven't come down at all relative to the last 6 to 9 months.

The difference being the suitors send to be overwhelming strategic, which, of course, wouldn't surprise you, and fewer and fewer financial sponsors just given the current credit environment, but the pipeline's full. As we go forward to make an acquisition, our intent is to continue to build our capital base and bring in acquisitions at above our cost of capital, which we believe in the long-term creates shareholder value. That being said, we had a board meeting yesterday. We discuss each and every acquisition with our board, and before we make it to the extent it's our cash, and it's our desire to maintain our upper tier investment grade, we look at each and every acquisition strategically, and financially, relative to buying Stanley's stock, and in this environment, share repurchase probably gets a closer look then it would have historically but we have not changed our priorities and we've not changed our strategy.

Operator

Your next question comes from the line of Peter Lisnic with Robert W. Baird.

John Lundgren - *The Stanley Works - Chairman, CEO*

Hi, Pete.

Peter Lisnic - *Robert W Baird - Analyst*

Jim, if I could, just to clarify on the back half of the year guidance, down 3% organic in the first quarter sounds like second quarter kind of the same number. Does the second half of the year kind of run along at that minus 3% or are you expecting improvement? I just want to make sure I understand that.

Jim Loree - *The Stanley Works - CFO*

Our guidance is $4.20 to $4.40 a share and that, as John mentioned as he went through his presentation is predicated on, was predicated on a short or a short-lived and mild recession in the U.S. and without a major global recession. So, with the issue we're facing that right now is that -- it's not even an issue. We're exactly where we thought we would be when we issued the guidance, which was the first quarter would be really tough and the second quarter would be tough, and then in theory if our assumptions hold true, the third and fourth quarters should get better.

There's all sorts of stimulus going on as you know, with respect to interest rate reductions, with respect to fiscal stimulus as well, putting checks in people's hands in the U.S. and there are a number of reasons to think that it's possible to think that it could be better in the second half but I don't think anybody's going to bet on that, certainly not us, but we're consistent with where we thought we would be. The wild card in the whole economic outlook for us has been the shakiness of the overall financial system over the past few months has really created more concerns on the part of most folks here then we had before and so -- now we've seen some abatement in the last few weeks of that in particular with Bear Stearns' rescue and so forth.

So if the financial system stabilizes, the stimulus works, I think there's a good possibility that we could have an okay second half, which would put us right smack in the range of our consensus, but we want to give you a sense, and I think I saw a report from one of the analysts on the call who sort of pegged it as we're sort of trying to quantify what we believe the downside to be for you if that doesn't occur, and the downside is that we can still generate earnings growth while a number of our building products competitors' earnings are tanking 20 to 30% versus the prior year, and that's a direct result of the portfolio shift and also what we consider to be a fairly direct response to the economic environment in terms of cost reductions and price inflation recovery.

Peter Lisnic - *Robert W Baird - Analyst*

Okay. That's very helpful. Thank you for that one and then my followup question, I guess if I look at the CDIY segment, and if understood John correctly, it sounds like there was a $20 million raw material hit in the the first quarter or was there a price offset?

John Lundgren - *The Stanley Works - Chairman, CEO*

I mentioned that $20 million when I was talking about CDIY, and the majority of it is in CDIY because it's steel and that's Bostitch and that's hand tools, so the majority of it is there. That 19, $20 million was on top of the 75 to 80 to get to the 100 that Jim referenced previously. We entered the year saying 75 to 80. We absorbed another 20 in February to get us to 100 -- or 20 to 25 to get us to 100 for the year and those are the price offsets we worked hard to get into place. In other words, we were looking at 80% recovery when the number was 75. We're now looking at 90% recovery of 100. We're still looking at $10 million of negative price inflation, which, of course, we're going to go get from productivity. That's all on an annualizes basis.

Jim Loree - *The Stanley Works - CFO*

We expect to have gross margin accretion. As I mentioned last fall, we expect about $70 million of variable cost productivity, which should fall through and except for the unrecovered piece of the inflation which at this point is about $10 million.

John Lundgren - *The Stanley Works - Chairman, CEO*

That was indicative, first quarter you saw 60 basis points of margin accretion despite all of the activity that was going on out there and despite soft volume relative to our plan.

Operator

Your next question comes from the line of Robert Wertheimer with Morgan Stanley.

Robert Wertheimer - *Morgan Stanley - Analyst*

Good morning, everybody. You said something in the opening commentary that peaked my interest. You talked about renegotiating supplier terms and I wonder if that's because your suppliers are really starting to feel the credit crunch and whether there's any risk there.

Jim Loree - *The Stanley Works - CFO*

No, it's really a function of, in particular, the Asian suppliers who for two or three years we have been able to stave off the price increases while they've experienced significant raw material price increases. And we sort of expected that sooner or later it would come to this and a lot of them have basically decided that they can no longer ship under the previous prices and so they come to us and say well we don't want to do business with you anymore because you won't accept a price increase, and you haven't accepted a price increase in two or three years and our prices have gone up X% on steel and other input costs. We begrudgingly grant those. And we have a process to fully analyze their price structure and work with them to do value engineering, to reduce the impact of the price increases to us, and so on, but ultimately we've taken price increases from some of these Asian suppliers and in almost every instance when that's happened, we've said we're not taking any price increase unless you extend the terms 30 to 60 days from what they are are and that's basically most of what the payables increases resulting from as well as currency. John didn't mention the currency when he was talking but the currency had an impact as well.

Robert Wertheimer - *Morgan Stanley - Analyst*

Fair enough. Just mechanically on your price increases, the one you just took, is that typical timing for the year, and can you talk about how often you do pricing for the year.

John Lundgren - *The Stanley Works - Chairman, CEO*

I have to talk by segment. Let me take the easy ones first. Easy to explain, not easy to get price increases. In security and in our industrial business because most of us is B to B, most of our customers are in the very similar situation as we are. It tends to be far more transparent and their willingness to accept and pass on a price increase is understood because they're in the same situation we are so it tends to be relatively quick, 30 to 45 days notice and it passes through and they have the same capability to pass it on through. That 90% price recovery that Jim talked about, That's on a corporate-wide basis. The number's higher than 90 in security and industrial and below that in CDIY, and the reason there I think is pretty obvious and straight forward.

A very large percentage of the CDIY business is sold through the North American and European home centers. Large retailers with a lot of leverage and just as we have formal processes to fully vet and in an essence resist price increases until we're sure that they're merited, they have the same leverage and they have it from a 40 to $80 billion revenue base, and it takes a lot of work. A lot of working with the supplier and a lot of negotiation on what else can change so they can keep their costs and ultimately their retail prices as low as possible. So it takes three to six months in some cases to truly realize the benefits of a price increase in part of our CDIY channel. It's more 30 to 60 days in some of the other channels. That's not unique to Stanley. It just reflects the difference in the channels and how the pricing models work.

Robert Wertheimer - *Morgan Stanley - Analyst*

Okay. Thanks.

Operator

Your next question comes from the line of Sam Darkatsh with Raymond James.

Jeff - *Raymond James - Analyst*

Yes, this is Jeff calling in for Sam.

John Lundgren - *The Stanley Works - Chairman, CEO*

Okay.

Jeff - *Raymond James - Analyst*

First question is we were pretty encouraged by the U.S. systems and integration business. I was hoping you could talk about that a little bit and whether or not you were surprised at all about how good that came in and what is your plan --

John Lundgren - *The Stanley Works - Chairman, CEO*

We too were encouraged. We weren't surprised. Jim is right in the middle of it so I'm going to ask him to take that.

Jim Loree - *The Stanley Works - CFO*

The encouraging thing about is it's happening little faster than we expected. If you look at what we said in the past, we're expecting to go through the first half of this year with continued negative organic growth in that particular part of the business and as it turned out, we were able to emerge two quarters earlier with organic growth and the reason that is that we had a fair amount of sales turnover last year that was anticipated, but the folks that have stayed and the new folks clearly have bought into the business model, which involves recurring revenue as well as installation revenue as part of the sale process. They bought into the compensation plans that we have and we're finding that gaining share is feasible in particular at the national accounts. We've been a welcome alternative to the other supplier out there or suppliers, and in general, Convergent Security is really picking up momentum and we feel very good about it.

Jeff - *Raymond James - Analyst*

Okay. My followup is in regards to, in your script you mentioned something about the automotive business weakness and it sounds, basically based on what you said is maybe there's a little more than market weakness. Could you talk about that?

John Lundgren - *The Stanley Works - Chairman, CEO*

Yes, let's start by hopefully it didn't sound like we're reading a script because we don't do that, but I do understand in the formal comments. Let me distinguish between our small OEM business. Assembly, which is facing the same marketplace headwinds obviously that anybody supplying the North American or European automotive business would do, that business is soft from a topline perspective, that team's done a great job adjusting its cost base to stay in line with it and in fact saw some margin accretion as a result of it. The issue there is volume. The rest of the business though, what we do call industrial and automotive repair. You think some of Proto, some of Facom and certainly Mac it's been difficult.

If you think of the Mac model, the drivers are paying for their own gasoline. That's extraordinarily expensive and a large part of the Mac top line comes from very high ticket items sold on consumer credit, which their end users are having difficulty, quite frankly coming up with the credit to buy it. So a lot of that softness is driven by the combination of energy prices and tight credit in the end user market for that particular segment because the industrial part of that business is performing extraordinarily well. That's Proto, the part of Facom that goes to industrial in Europe. We're quite pleased with how they're performing, so if it involves consumer credit, if it involves gasoline, it's going to be tough in the end marketplace, and lastly, we don't talk too much about individual businesses but we're making progress with -- I'll say a distributor recruiting model with Mac, where historically we looked very, very hard and very closely at how many distributors did we add. How many distributors did we lose in a particular quarter with not enough focus on retention. The way the business model works is we need to keep these people for 12 to 18 months before they turn profitable.

I won't bore you with the details, but the Mac team has really stepped up the sophistication and the scrutiny under which they look at distributors before they add them. The end result is we're going to add fewer distributors without question, because the bar for them to clear and become a distributor is much higher. The theory is that while we'll be adding fewer distributors, our retention rate will be dramatically higher and in the long run that will be right for Stanley. We're only one and a half quarters into this new process so I can't tell you yet that it's working but I know both at the Mac level, Don Macelmay who is responsible for our industrial tools group as well as those of us at headquarters in the HR function as well as senior executive management looked at the program, think it's the right way to go and we're cautiously optimistic that's going to help them but right now it's a difficult environment.

Jeff - *Raymond James - Analyst*

Thank you.

Operator

Your next question comes from the line of Chitra Sundaram with Cardinal Capital.

Chitra Sundaram - *Cardinal Capital - Analyst*

Thank you, my main question was when we talk about organic growth in the various segments of the rest of the world, is it possible to discuss them on a constant currency or local currency basis? So we have a better idea, for example, Facom or the rest of the world 6% CDIY. What we're talking about on a local currency basis?

Jim Loree - *The Stanley Works - CFO*

We do that specifically, our organic growth numbers exclude any foreign currency translation. So if the number is organic it has no currency in it and it is what it is.

Operator

Your final question comes from the line of Jim Lucas with Janney Montgomery.

Jim Lucas - *Janney Montgomery Scott - Analyst*

My question was answered, thank you.

Operator

At this time there are no further questions.

John Lundgren - *The Stanley Works - Chairman, CEO*

Okay. Well listen, thank everybody for their attention. Busy day, a lot of earnings releases out and we very much appreciate those of you who were able to join us live today. As always, Gerry and Greg actually are both available if you have a specific followup question you didn't get answered or our comments have raised a question that you didn't get to ask, we would be happy to hear from you. Thank you very much for your interest and participation this morning.

Operator

Thank you for participating in today's Stanley Works' conference call. This does conclude the conference call. You may disconnect.