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PRESENTATION

Operator

Good morning. I will be your conference operator today. At this time, I would like to welcome everyone to The Stanley Works Q1 2009 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). At this time, I would like to hand the call over to Ms. White, Director of Investor Relations. Please go ahead.

Kate White - *The Stanley Works - Director IR*

Thanks so much, Jen. Good morning, everyone. My name is Kate White, the Director of Investor Relations for The Stanley Works. Thank you, all, very much, for joining us on the call this morning. On the call in addition to myself is John Lundgren, Stanley's Chairman and CEO; Jim Loree, Stanley's Executive Vice President and COO; and Don Allan, Stanley's Vice President and CFO.

I would like to point out that our first quarter 2009 earnings release, which was issued this morning, and the presentation supplementing today's call, which we will refer to during the call, are available on the Investor Relations portion of our website, which is www.stanleyworks.com. This morning Jim, John, and Don will review Stanley's first quarter 2009 results and various other topic matters followed by a Q&A session. The entire call is expected to last approximately an hour and a replay of the call will be available beginning at 2:00 PM today. The replay number and access code are in our press release, which again is on our website and as always, please feel free to contact me with any follow-up questions after today's call at 860-827-3833 or Corbin Walburger at 860-827-3937.

We will be making some forward-looking statements today during this call. Such statements are based on assumptions of future events that may not prove to be accurate as they involve risks and uncertainties. It is therefore possible that actual results may differ materially from any forward-looking statements that risks and uncertainties we might make today, and we direct you to the cautionary statements in the Form 8-K which we have filed today with the press release. With that, I will now turn it over to our CEO, John Lundgren.

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

Thanks, Kate. Let me spend a minute just on the highlights from the first quarter and the state of Stanley. I think it will help ground everyone.

First quarter as cited in our release, diluted EPS from continuing ops of $0.48. That did include about $0.08 of the restructuring charges that we plan to take this year that we have been fairly transparent in terms of what we think they will be and when we think they will fall and Don will talk more about that later. The highlight was security, I think validating the portfolio transition that we began five or six years ago, 12% revenue growth and 33% profit growth. Of course that was primarily driven by acquisitions. But that being said, we are very pleased with the integration status of both Sonitrol and GDP, as they are on or ahead of schedule in terms of where they need to be on cost savings, and Brett Bontrager and the integrations teams continue to do a really good job in that area, and it really helped fortify the quarter.

Overall, sales unit volumes are down 19% versus prior year, but in that environment, gross margins still improved to a record 39.6% for us in the first quarter. We will hear more about this later on, but we have taken additional $100 million cost reduction program that we initiated. That should generate up to $45 million in savings this year, and $15 million of that we will reinvest in brand development programs and some organic growth initiatives, some of which has already been reinvested, and Jim will talk a little bit about that in his portion of the presentation. Despite the volume decline, working capital turns improved to 4.8 and 2009 GAAP EPS guidance was introduced for the first time in the range of $2 to $2.50. That includes $0.42 of restructuring, so about 20% of the restructuring that we intend to take this year took place in the first quarter. Free cash flow we still expect to be above $300 million.

Looking briefly at the financial results, the chart is self-explanatory. We were pleased to be able to hold operating margin at about 12%, given the precipitous volume decline, but you see earnings excluding the $0.08 charge at $0.56 are down 30% from first quarter year ago. Revenue down 15% -- we'll be more explicit on that in the next chart. Tax rate constant. Numbers of shares outstanding constant. I think importantly to note, we did not maintain margin by producing for liquidations and building inventory. Inventory was down about 13% in absolute terms and there was only a modest four day increase in days sales in inventory despite the 19% volume decline. So the benefits of SFS are clearly showing up in terms of our ability to manage inventory, manage working capital, and Don is going to give you more detail on that in light of the volume declines. Our ability to maintain OM reflects price acquisitions, productivity, and favorable mix offsetting the adverse impacts -- of course the volume decline FX and still a little bit of cost of goods inflation in the first quarter.

Looking more specifically at revenues on chart 5 -- down 15% as I said, but looking at a quick walk, volume down 19% and just for everyone to recall, that followed a 7% volume decline in the third quarter and a 10% volume decline in the fourth quarter. So the 19% was in fact significantly higher than we anticipated as we entered the year. We have reacted to that. Jim is going to talk to that just -- in just a minute or two. We got favorable price impact resulting in organic revenue decline of 16%, hurt by currency, helped by acquisition. So revenue down 15% with of course security being the bright spot. Looking at the segment results, you see security up 12% with volume being down 8%, but the both industrial and CDIY businesses, volume down 26% and 22%, leading to the 19%. As it relates to the security, and we have talked about this a lot, it's insulated from but certainly not immune to the economic headwinds that we are facing, as installations were down, but that was certainly partially offset by some healthy resigns, and obviously from a margin perspective the recurring monthly revenue of our Convergent security business.

On slide 6 no area escaped the headwinds. If we are looking just quickly, the top left, North America accounts for about 64% of Stanley's revenues and Canada was down 16% in total, 12% organically and the US down 14% organically. Europe fell -- the fall came later but more precipitously. Europe was doing pretty well up until about September 2008, and declined quickly from September onwards and certainly remains soft at this point in time. Australia, given its small size, is a relatively important market for Stanley, but it was down 6% organically, 31% in total as currency was a big factor, and Asia down as well after some significant consecutive quarters of growth.

Looking at margins, on slide 7, the high point of the quarter may well have been our gross margin achievement of 39.6%, as I alluded to earlier -- price acquisitions and mix as well as strong performance by our security business. Operating margin did decline 40 basis points versus first quarter 2008 and 80 basis points sequentially due primarily to volume. SG&A was down and I'll give you some more detail on that in the next slide. But, obviously, it was down less than volume as we were not able to adjust it as quickly to volume decline 400 to 500 basis points above what we had anticipated as we entered the quarter.

But to give you a closer look at SG&A, down 8% in total, but there are a lot of moving pieces, so we prepared this walk that we thought would be helpful. I think on the whole we did a good job controlling SG&A given the level of volume decline. As I say, down 8% in total, but down 16% excluding the impact of acquisitions. Most businesses, which is not on the chart, but most of our businesses were down in excess of 20% with the exception of security and it was down -- the two security businesses were down mid single digits but, again, but not facing quite the marketplace headwinds as our industrial tools and CDIY business were down a little bit less.

As you look at the walk, it's pretty straightforward, acquisitions adding $23 million, investments adding $4 million to the spend -- and that's some of our incremental brand support, most particularly support of expansion of our very successful to date major league baseball program. I won't steal Jim's thunder. He's going to talk about that a little bit, and we are very excited about the brand building and potential volume building aspects of this program. Inflation was another $2 million and then all the savings, 13% reduction versus our 1Q 2008 cost basis between headcount, foreign exchange -- a lot of moving pieces in discretionary spending, the biggest of which is T&E or travel, fewer promotions, virtually no temps on our payroll, everything right down to office supplies, $20 million in the quarter. Again, a fairly formidable effort controlling expenses, which helped maintain margins.

As we detailed in our press release, we did take additional actions in the first quarter as we observed the volume declining more than we previously anticipated. Jim is going to give you a little more granularity on what those actions are, the impact as it relates to restructuring costs, and what to look at for the rest of the year. And then Jim is also going to give you some more detail on each of the segments. So I'll turn it over to Jim Loree.

Jim Loree - *The Stanley Works - COO & EVP*

Thanks, John. Before we delve into the new actions, which are the ones that we took in the first quarter, I'd like to just refresh everybody by summarizing the actions that we took in 2008 primarily in the fourth quarter. We exited the year with about $220 million in cost actions, of which about $195 million of that or $1.75 per share impact 2009's cost base. Another $25 million will impact 2010. About half of the impact related to headcount for those actions, with about 2,000 people coming out or about 10% of the workforce. Another 25% of the savings came from discretionary items such as the suspension of our 401(k) match and some deep cuts into things like T&E and other discretionary items, some of which will come back. In fact, I think we can be fairly certain that about 25% of these will actually come back in 2010. And then the remaining 25% are other expense reductions that are more permanent in nature, the type that typically will follow headcount actions. So about 75% of those 2008 actions we expect to be permanent.

And then we move on to the first quarter 2009 actions, and as you may recall, as we exited the year, we committed to produce a contingency plan that would protect us in the event that the volume forecast for 2009 was less robust than the minus 10%. And as the quarter went on and as you can see from the organic growth in volume, physical volume declines, it became clear that it would be appropriate to implement these actions at the end of the quarter. So as we look at the 1Q 2009 actions, we have an additional headcount reduction of 550, bringing our total to 2,550 from the beginning of last year or about 13% of the total workforce. As mentioned, there's about $100 million of annualized savings associated with these cuts, about $45 million in 2009, of which 75% of that are related to the headcount and then the remainder from costs that follow headcount. So, again, these would be primarily all permanent in nature. The charges associated with that, $45 million restructuring, most of which is related to the 4Q 2008 actions, $0.42 a share, and the charges are going to be primarily 90% cash. So as you can see, mostly severance and items of that nature.

So we talked quite a bit already about the savings. You have the $1.75 a share from the 2008 actions, and then an additional $0.51 in 2010 from that. A combined benefit of $0.75 in 2010 will largely be used to offset the cost pressures from those costs that I mentioned from the 2008 savings will be coming back. And I think it's fair to expect that about $0.40 to $0.50 of those 2008 actions could be coming back, especially the 401(k) match and some of the DT&E reductions.

Now, one of the nice elements of this was that we were able to take $15 million of these savings and reinvest them in organic growth in the security business, particularly in the electronic business, and it's our intent this year to add about 150 salespeople into the electronic security business. We have the ability to gain share, we have a market that is willing and able to accept additional sales resources, and these folks can be productive. And we have some competitors that are retrenching to some extent, so we can hire folks that are already up to speed and have an account base. So we are making that move. In addition to that, we will talk in a minute about the brand investment in Major League Baseball and the Nascar sponsorship.

But I think it's also important to note that these actions, unlike those in the fourth quarter, I would characterize the actions in the fourth quarter as more traditional cost cutting. These actions were very thoughtful in terms of changing the structure of the company in ways that could actually improve the effectiveness and not just the efficiency or not just derive efficiency benefits. So for an example, as we announced in the press release, we combined the CT&S and Bostitch businesses under one management team under Jeff Ansell. This will provide significant benefits in the form of accelerated product innovation, channel efficiencies, since many of these customers and channels in fact overlap and provide us I think with significant share gain potential in the coming years.

In addition, another change that we made was we took our supply and services business and combined it with Mac, and now we are able to use the supply chain associated with supply and services, which has a terrific operating performance of something like 10 working capital turns, very efficient supply chain. And that will actually replace ultimately the Mac supply chain over time. So another example of ways we are extracting effectiveness and not just efficiency.

And then a third example is we took the company's health care business units, several of which were in security and several of which were in engineered solutions. And for internal purposes we have combined those under one leader and we expect to gain additional efficiencies from that included in the cost savings, but also the beginnings of a new growth platform for the company in healthcare solutions. So I think the difference between these costs actions and the ones that we took in the latter half of 2008 are that we had enough time to think through these very carefully and do some things that we think will improve the effectiveness of the operation on a go forward basis.

Now I'll talk a little bit more about the brand reinvestment initiative. And those of you who have either followed -- or follow baseball or watch ESPN's Sports Center, you may have noticed a growing Stanley presence in Major League Baseball parks from coast to coast. And as it turns out, we are now in eight Major League Baseball parks, the interior -- generally in the outfield or scoreboard areas. And we took advantage of a situation where the banks and the auto companies have backed off from as much advertising as they were doing for obvious reasons and the pricing came down dramatically. We have been circling this type of a sponsorship for several years now, contemplating doing it, but it was -- we felt it was a little too expensive in the past.

But with the prices coming down the way they did, it was a great opportunity for us to team up with Major League Baseball and the eight teams represented on the page.

Of course we had the Boston Red Sox pilot had been going on for about 1.5 years, and so the additional seven teams that are represented here are all new. And I would say that one of the thrusts here was to concentrate on the Hispanic markets. So you'll see several of these are in areas where there's significant Hispanic concentrations, such as Florida and Texas and California and the purpose there is, as we try to continue to develop the brand with the Hispanic community, we find that baseball is a great way to reach that particular demographic. So that's one area you can see the pictures there. You've got US Cellular field in Chicago, you can see the large Stanley sign there, and then Hubert Humphrey Metrodome in Minnesota -- the right field wall is literally covered with five Stanley logos in the Twins ballpark.

We also continue our investment in NASCAR. We upgraded the number of races this year. We upgraded the level of sponsorship. As you saw we were in the Daytona 500 with our number 19 car driven by Elliott Sadler placed number 2 in the Daytona 500. Got tremendous press from that.

And then finally on the left-hand side of your page, I want to call your attention to a new innovative advertising medium for us -- the iPhone. In an iPhone application we actually have a level application where the iPhone actually works as a level, and you can actually go to the apps store on the iPhone, search for Stanley. It's a free download and quite a few folks have done that already. This functions as a level but it also has significant product information associated with it. So I urge anyone who has access to an iPhone to check it out. I think it's indicative of the fact of how we are trying to contemporize our advertising messages as well.

Let's move on now to the segments. Security was the bright story of the quarter for us clearly with revenues up 12%, just modest decline in organic sales, just down 4%. Segment profit up one-third and a margin expansion of segment profit to 18.9%, 290 basis points, which was also a sequential improvement of 50 basis points versus the fourth quarter performance.

Convergent had a terrific quarter with their acquisitions of Sonitrol midyear last year and General de Protection in September of last year, providing revenue growth and offsetting the mid-single-digit organic volume decline that was experienced primarily from lower installation sales as John earlier pointed out.

And the mechanical business also had a terrific quarter on a relative basis. I think if you -- if you look into some of their competitors and their performances, I think you'll see that they clearly gained share in the quarter. They had about a 4% revenue decrease, but they had excellent margin performance as the cost reductions that we talked about earlier and some good price inflation arbitrage kicked in and helped them with their operating profits. So good story there as well and security continues to buttress the overall company's performance in this very difficult environment.

And then we move on to the other segments, industrial being the tougher, I guess, of the two stories from the standpoint of sequential performance, with revenues down 29%, organic growth of minus 24%, versus minus 9% as an example in the fourth quarter, and what we have going on here is a weak market for sure, but on top of that we have a very massive inventory correction going on. And I think it's exacerbated by the credit crunch and the distributors in the supply chain really have challenges in terms of gaining financing and maintaining the level of inventories they would like to maintain, and also just playing it cautious. So we think about 8 points of the decline was associated with an inventory correction, which we think will probably continue into the second quarter. Segment profit was down about 50%, down to $25 million and the segment profit rate, while it was down 420 basis points, we were pleased to be able to deliver still a double-digit operating profit under those circumstances.

So moving onto construction and DIY, another tough revenue story with total revenues down 25%, exchange exacerbating that issue with organic growth minus 18%, but the order rates were about 3 points better than the organic growth, so that's encouraging. I think the other item of note is that the point of sale for our seven largest North American customers was only down 9% during the quarter and it was fairly stable. So I think that's indicative that the end end markets are really not in as bad a condition as the performance would indicate in the segment. Europe was very difficult as organic revenues declined 20% and the cost actions that we have taken are lagging clearly in Europe because of the normal time delays that are involved with reducing headcount in the European area. The other thing to note on the page I think that is also encouraging is that the operating profit rate in the segment was 9.5%, which was higher by about 3 points than the fourth quarter. So we talked about last quarter that that was the 6.4% might potentially be a trough, and it looks like that may well be the case as we go here.

Moving onto working capital on the next page, we continue to exhibit good control over our working capital, with our inventories coming down 13% to $504 million with a four day improvement there. We like where the inventories are positioned right now, because the overall reduction in inventories is relatively consistent with our overall organic growth forecast for the quarter, which means that while we have brought our inventories down responsibly, we are also positioned to serve, if and when the market comes back, and I think that's very important.

Receivables is a terrific story, down 24% to $659 million, down over $200 million. The big story here is not only, as you might expect, coming down in proportion to volume, but also delinquencies coming down. And the greater than one day delinquencies are down substantially, about $90 million year over year. So in this tough economic environment we continue to focus on making sure that the receivables are collected and that we keep our delinquencies down.

Payables was a user of cash on a year-over-year basis and also on a quarter-to-quarter basis. They dropped over $100 million year over year as the inventory reductions took their toll, and in addition to that, the SG&A reductions also affect payables and so that's what you see going on there. But all in all, 4.7 last year, 4.8 turns this year, very much in check and I think we are positioned nicely for the type of environment that we are in.

Free cash flow for the quarter, minus $18 million, nothing to be concerned about. Our outlook of $300 million plus for the year stands. The working capital usage in the quarter was negative $45 million, had a big payables impact hitting that. And as you can see from the box there, the working capital typically is negative in the first quarter, so that's nothing that has us overly concerned. Other was a little lower than usual. We had about a $30 million outflow of some cash associated with derivatives related to exchange, which was the anomaly there, and we would expect to see the rest -- the remainder of the year very strong from a cash flow perspective.

Moving onto 16, page 16, the next page is our balance sheet and it's very, very stable from fourth quarter to first quarter. As you can see, the debt to capital hanging in there at 48% and the adjusted debt to capital for the hybrid financing and the convertible in the 35% to 37% range. You will note that we were downgraded during the quarter by Moody's and we were reaffirmed by Fitch and we at this point have not seen anything from S&P at this point in time. However, at the moment we have a split rating, but it's still an A2, a single A in both Fitch and in S&P, and then A minus from Moody's.

So that's the state of affairs there. I'll turn it over now to Don Allan, who will take you through the guidance.

Don Allan - *The Stanley Works - CFO & VP*

Thanks, Jim. On page 17, as we mentioned in our press release today, we feel that we have sufficient visibility into our end markets and wanted to provide detailed guidance today for the remainder of the year. We do expect sales volume weakness to continue for the remainder of the year, and as you can see with the first assumption as we walk from our $2.82 of GAAP EPS in 2008 that our range of unit volume is a negative 13% to a negative 15%. The assumptions behind this is that as you heard from John and Jim earlier, negative 19% in Q1 was the unit volume. Result, we expect that likely to continue in the second quarter. And then in the back half of the year as the comparisons get easier, we expect the unit volume to approximate about 10%, which would get you to that range of 13% to 15%. Just to keep in mind, the EPS estimate of $2.90 to $2.40 associated with this is not only the volume decline, but it's also the plant underabsorption impact as we see those negative volumes year over year.

The next item is currency. Currency is not -- it's moved up and down a lot in the last three months, but as of the last day or so, it's pretty consistent with where it was in January when we provided this $0.50 assumption year over year. So it's relatively consistent. And to also keep in mind that the main currencies that affect us are the Euro, the UK pound, the Australian dollar and the Canadian dollar. And last but not least on that matter, any 5% movement, i.e. the strengthening of the US dollar or the weakening of the US dollar by 5%, would have an EPS impact of about $0.10 to $0.15 either way.

Moving onto the cost initiatives. Jim touched on the $1.75 or $195 million of actions already, so I won't repeat that. The next item is the first quarter cost reduction initiatives, which are net of that reinvestment Jim described. So the gross savings are $45 million as he mentioned on the $100 million annualized program and $15 million of a reinvestment which nets to the $0.28 EPS or $30 million. Acquisitions -- GDP, Sonitrol, ex [market scan] module -- carryover effect of that consistent with our January guidance or January factors we provided of $0.10 of a positive. And then last but certainly not least, we do expect lower restructuring charges in 2009 versus 2008 of $0.45. As you remember, we had $92 million of charges in 2008 and we expect to have $45 million in 2009. $35 million of that relates to the new production programs we are talking about today that we initiated in the first quarter. So the end result of that is a range of $2 to $2.50 EPS. And the main variable, obviously, is unit volume, as you can see.

So to summarize this morning's call, we feel that we have positioned ourself very well by taking some important strategic restructuring actions to lower our costs further beyond what we did in the fourth quarter of 2008. But at the same time, we took some of those savings and reinvested in important areas like our brands and organic growth opportunities in our security business. We will continue to be focused on paying down our debt as our free cash flow estimates should be greater than $300 million this year. We will be able to deleverage ourself during the year by about $200 million. As always, we are dedicated to go forward with our SFS success and drive working capital benefit throughout the year and see the types of returns we have seen over the last year or two. And we will continue to be disciplined about our pricing approach with our customers and maintaining our SG&A at the right levels to maximize our margins as we go forward. That concludes the presentation portion of our call today.

Kate White - *The Stanley Works - Director IR*

Jen, we're now ready for the questions-and-answers.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). The first question comes from Eric Bosshard. Your line is open.

Eric Bosshard - *Cleveland Research Company - Analyst*

Good morning.

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

Hey, Eric.

Eric Bosshard - *Cleveland Research Company - Analyst*

In the security business, the performance there, obviously quite good relative to the other businesses. As we look through the rest of the year, is the organic revenue decline in 1Q what you expect? Or what are you seeing go on in the business that would suggest where the demand is going to go as we work through the year in that business?

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

I think Eric -- this is John. I think what you said is what we would continue to expect. There is no question that installations are down and depending on the business, mechanical versus Convergent, installations account for a larger percentage of the revenue. We would expect to see installations stay at the low rate they are. The long-term issue with that, of course, is without robust installations, we can't continue to increase our occurring revenue base. Short to intermediate term, the advantage of that of course is as installs are down, recurring revenue becomes the larger percentage of the base going forward and it's very, very favorable in terms of mix. So -- but a modest decrease, high single to low double-digit decline in installs is our projection for the remainder of the year.

Eric Bosshard - *Cleveland Research Company - Analyst*

And so when that rolls back up to the overall organic performance out of security and what the guidance today -- and I know you're not giving guidance by segment, but should we assume that security is going to continue to run down in that 5% range?

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

Yes, I think that's a good assumption, Eric. We are, I think -- there's enough uncertainty but your logic is right on. It's consistent with our thinking. And without giving specific guidance, that's certainly how Brett, Justin, and their teams are planning their quarters rolling forward.

Kate White - *The Stanley Works - Director IR*

Jennifer, next question, please.

Operator

The next question comes from Sam Darkatsh. Your line is open.

Sam Darkatsh - *Raymond James & Associates - Analyst*

Good morning, folks. How are you?

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

Good.

Jim Loree - *The Stanley Works - COO & EVP*

Hey, Sam.

Sam Darkatsh - *Raymond James & Associates - Analyst*

Pricing was up 3% and you're not expecting any inflation and I suspect you're not looking for a net pricing on a year on year basis. So are you already starting to see deflation? Or what are the chances that pricing is favorable for this year and how should we look at price mix for '09?

Don Allan - *The Stanley Works - CFO & VP*

Hey, Sam, this is Don. I think the assumptions that we provided you, all of you in the first quarter around pricing and inflation on a net basis still hold true and I think we have seen a slight positive benefit of price versus inflation in the first quarter. But we will continue to monitor that going forward. But those estimates that we provided for the year in that timeframe on a net basis with a slight positive I think still holds true.

Sam Darkatsh - *Raymond James & Associates - Analyst*

Now, would that be primarily -- is this a deflation that you would see I'm guessing would be mostly CDIY and industrial? So if we are trying to look at how pricing affects each of those segments, is that how to look at that? And how much of a degradation might we see in CDIY and industrial from a pricing standpoint?

Don Allan - *The Stanley Works - CFO & VP*

I don't think we want to get into specifics about pricing about CDIY and industrial, but I think in general you can take the assumptions I provided and apply it to those segments.

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

And any degradation in pricing is going to depend a lot on commodities pricing. Obviously the pricing pressure is going to be directionally consistent, but lag commodities deflation which we are starting to experience at this time in the second quarter.

Sam Darkatsh - *Raymond James & Associates - Analyst*

So we should just model for essentially a push between materials and pricing, and that would be okay from a modeling standpoint?

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

Sounds logical to me.

Don Allan - *The Stanley Works - CFO & VP*

Yes, that makes sense.

Sam Darkatsh - *Raymond James & Associates - Analyst*

Thank you very much.

Kate White - *The Stanley Works - Director IR*

Next question, Jen.

Operator

The next question comes from Peter Lisnic. Your line is open.

Peter Lisnic - *Robert W. Baird & Company, Inc. - Analyst*

Good morning, everyone.

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

Pete, good morning.

Peter Lisnic - *Robert W. Baird & Company, Inc. - Analyst*

I was just wondering if we could explore this concept of structural savings and maybe to begin with, talk about from these restructuring programs how that filters through down to the segment level? And then is there a volume dependency to where the 75% or so that's permanent becomes lesser of a number?

Jim Loree - *The Stanley Works - COO & EVP*

Well, certainly there's always going to be some slight flex in SG&A and in gross margin costs associated with volume, but it is really not going to be substantial. It's not a huge -- if it were that large, you would have seen it coming down and we wouldn't have to take all these costs out. So it's not -- I wouldn't make that a very large part of my analysis. I'm not sure exactly what the question you wanted to ask on the structural side was. Maybe you could try that one again.

Peter Lisnic - *Robert W. Baird & Company, Inc. - Analyst*

Well, what I'm really trying to figure out is we've got the permanents down, I'm trying to figure out by segment what the incrementals or decrementals are going to look like going forward, because it sounds like the structural profitability of the business is changing from some of these actions.

Jim Loree - *The Stanley Works - COO & EVP*

Fair enough. Let me give you some rough, rough numbers that will allow you to do what you want to do. Roughly 50% the cost take-out thus far from the two initiatives is in the CDIY segment and then the other two are about 25%, 25%. And that is probably enough to get you what you need.

Peter Lisnic - *Robert W. Baird & Company, Inc. - Analyst*

That is perfect. Thank you very much.

Kate White - *The Stanley Works - Director IR*

Next question, Jen.

Operator

The next question comes from Seth Weber. Your line is open.

Seth Weber - *BAS-ML - Analyst*

Good morning, everybody.

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

Seth, good morning.

Seth Weber - *BAS-ML - Analyst*

Hey, can you update us on what you're seeing on the security side with churn and cancellations and if you're seeing any unusual pricing there?

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

I'd say it's business as usual, which is changing rapidly. In terms of churn, you read what we read -- as retailers go out of business, obviously, that's short term, those are lost opportunities. Two issues there. From a credit perspective, not much of an issue at all. As you know, monitoring contracts and most of the security recurring revenue business are paid well in advance. So one of the reasons Don's team was able to achieve the tremendous improvement it did in receivables is because there's little or no risk of default on the securities side. The churn is there.

The good news is our security business, as you well know is overwhelmingly B2B, not consumer or residential, and when a large customer such as a Circuit City goes out of business, leaves 200 locations open, those buildings don't stay empty forever. And as competitors or different businesses move in, we are very active and very successful on what I alluded to as calling it resigns, so we will go back and keep that account. That's a big mitigator in terms of the business that's lost. So the challenge is to keep -- to re-sign the overwhelming majority of any business that was lost due to customer business failures. In terms of churn, fighting for share, et cetera, that goes on every day. The market is slightly smaller. We have several viable competitors in this business and we are all testing our business models. And we happen to believe ours is superior based on results to date. But no tremendous pricing pressure or predatory activities or targeted activities, anything of that nature, that doesn't go on every day in -- under better circumstances.

Seth Weber - *BAS-ML - Analyst*

Okay. Thanks. If I could ask a follow-up. Jim, as you talk about structurally changing the company a little bit, would that include shedding some assets, or maybe if you could give us some idea of where you might be thinking on the acquisition side, whether it's more healthcare, that kind of stuff?

Jim Loree - *The Stanley Works - COO & EVP*

Yes. I'm glad you asked that question because I did want to make the point at some point during the call that the capital allocation for this year is really focused on deleveraging. So don't expect to see much, if anything in the way of acquisitions in the current year. Once we get our debt to the levels that we are comfortable with, which would be at a minimum to get all of our short-term debt paid down this year, then as we go into next year -- and we are building a pipeline for that eventuality. But as we go into next year, I think you will start to see some acquisitions in the healthcare area and also electronic security and mechanical security and then possibly some tool consolidation acquisitions. It's quite possible in this distressed environment, when you start looking at the massive overcapacity and the volume declines that some of our competitors are experiencing, which in some cases are steeper than ours, I think that there's a good chance that there may be some consolidation in the tool industry at some point in time.

Seth Weber - *BAS-ML - Analyst*

Okay. Thanks very much, guys.

Jim Loree - *The Stanley Works - COO & EVP*

Thank you.

Kate White - *The Stanley Works - Director IR*

Next caller, Jen.

Operator

The next question comes from Nicole DeBlase. Your line is open.

Nicole DeBlase - *Deutsche Bank - Analyst*

Hi, guys, good morning.

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

Good morning, Nicole.

Nicole DeBlase - *Deutsche Bank - Analyst*

Question on inventories. You guys obviously did a really good performance year on year. If I look quarter over quarter, however, it looks like inventories were broadly flat. So my question then is what's your plan for inventory reductions in 2009? Is this trough inventory level that we are currently at? And then in what businesses are you guys seeing the highest inventory levels?

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

Sure. Don will take that. I think he can give you some specifics that we are very comfortable with.

Don Allan - *The Stanley Works - CFO & VP*

Hi, Nicole. No, to answer one of your questions, we don't expect the inventory level we saw in the first quarter to be where we are and where it's going to stay for the rest of the year. With the programs that we have in place under SFS, specifically around lien transformation or transformation of lien in our plants as well as the S&OP processes we have put in place, we do believe we will continue to see inventory reductions this year of a significant nature. And what you're seeing from the fourth quarter to the first quarter is just continued reaction to our volume decline sequentially. The accounts payable portion went down, you'll see inventory decline in the second quarter most likely and continued decline after that. So I would expect that trend that we saw last year to continue in inventory.

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

And I'll just add, Nicole, because I don't want you to get cut off if you try to ask a follow-up -- often we are asked where do customer inventories stand. Jim alluded to the fact in the industrial segment that data isn't as good and we don't get it as quickly, but our estimate is about one-third of our volume decline was due to destocking, credit issues in the two step channels, and within our industrial accounts. On the retail side, roughly, I'm comfortable saying inventories are not out of line. As you know, the large home centers run at 10 to 12 weeks, and our sense is that's where they are. I'm comfortable saying that. Obviously that's 10 to 12 weeks of a lower base. But there's certainly nothing from the marketplace perspective that suggests we are going to have -- we are going to be significantly impacted by that as we move to execute our own programs to continue to reduce our inventories.

Nicole DeBlase - *Deutsche Bank - Analyst*

Great. That's helpful. And then one follow-up, if I may. If you guys could quantify how much benefit from the headcount reductions you've taken thus far, you've seen in the first quarter, that would be helpful.

Jim Loree - *The Stanley Works - COO & EVP*

I think that -- if you look on the walk that we did for SG&A you can certainly see a 13% reduction in the first quarter, and then you have a portion in cost of sales as well, which is probably about $10 million to $15 million.

Operator

The next question comes from Ken Zener. Your line is open.

Ken Zener - *Macquarie Research Equities - Analyst*

Good morning.

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

Hi, Ken.

Ken Zener - *Macquarie Research Equities - Analyst*

Looking at security relative to the installation trends, how would you guys say what your kind of outlook? Do you guys use things like the Architectural Billings Index, and then could you also comment on the return prospects or payback that you're hoping to get out of the new Convergent sales force.

Jim Loree - *The Stanley Works - COO & EVP*

Okay. Well, there's a lot of different factors that go into forecasting installations -- for instance, how many feet on the street, what's the sales force productivity, what does the market look like and on and on and on. There's no magic to it. So we feel that the installations as we go into the next several quarters are going to be down consistent with the first quarter. The sales force ads, we are talking about roughly an 8% increase in the feet on the street in the Convergent business so to put it in perspective.

Ken Zener - *Macquarie Research Equities - Analyst*

Okay. And then given obviously that you guys have been very successful or aggressive on your restructuring actions and consistently taking out what's harder and harder to get, how -- if there were another stepdown, I mean, how much of the cost, because I think you guys have been fairly aggressive, are actually left in your guys' opinion? I mean, have you gone 70% of the way as to what you really think is reasonable?

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

I would argue that academically or theoretically we can continue to reduce costs consistent with volume declines, not quite as fast, almost in perpetuity. Do note, recognize that that 45% of our revenues are outside the US. And as Jim and I both touched on in our pieces of the presentation, right now our volume in Europe over the last five or six months is down even more than the US. And while we have the exact same objectives and strategy, I think everybody on the call is aware it takes a lot longer to rightsize a European manufacturing operation than it does a US or an Asian operation. So we have got -- the plans are in place and plans are proceeding, but it's going to take us a while to get those results. Our hope is by the time we see those, this will be over and volume will start to improve, but right now the cost benefits have been primarily in the US, secondarily in Asia, with Europe still to come -- or said differently, the European cost base needs to catch up with the volume decline in Europe and our team is well aware of that, and we are working with the appropriate works councils, unions, and government officials to reach the right solution.

Operator

The next question comes from Michael Rehaut. Your line is open.

Michael Rehaut - *JPMorgan Chase & Co. - Analyst*

Thanks. Good morning, everyone.

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

Good morning, Mike.

Michael Rehaut - *JPMorgan Chase & Co. - Analyst*

First question, just on the security margins -- very impressive continued stable performance on the margins and I was just wondering going forward what is your expectation if volume drops from here? I mean, it appears that a lot of the actions that you've taken have been in -- the restructuring actions have been more on the industrial and CDIY side, which has obviously borne very positive fruit in terms of the margins holding up there as well. On the security side, if you see a similar drop-off in sales, what are your thoughts in terms of downside to margins for let's say every 5%? And do you have similar kind of plans in place that would allow you to take quick action?

Jim Loree - *The Stanley Works - COO & EVP*

Well, Mike, as we said in the past, we really don't make a practice out of forecasting segment margins or trying to be that prescient about what might happen within certain segments. However, I guess what I can say is that there's a lot of costs in the security business and there's a lot of fixed costs and it's actually more -- there's more fixed costs in the security sales and service structure than probably any other such structure in the company because you have a lot of -- thousands of salespeople, thousands of vans, technicians, et cetera. In a manufacturing type of a segment, those would be up in all -- not the salespeople, but certainly the service and the installation and so forth would -- if there was such a thing, would be invariable costs. But in our case it's in the field structure. So when the -- if the revenues were to come down precipitously, and we don't think they are, and the reason we don't think they are because there is so much recurring revenue ,and you've see a fairly stressed out distressed quarter in the securities business and this is what it looks like. So we don't expect it to get worse.

But if it were, the next step would be to accelerate some of the cost reduction actions that are out there, opportunities that are out there in the field structure. And thus far we have avoided doing much of that. What we have done has been centralizing some functions and things like that that were heretofore provided in the field. But there is definitely the ability if we deem it necessary to go in and do some surgery with respect to the cost structure in the field. Hopefully we won't have to do that, and as you can see we are adding back resources, not taking them out at this point.

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

Mike, this is John. Remember, when I gave you a little granularity on SG&A, there was no business or segment split, but I alluded to most businesses, CDIY industrial, SG&A was down in excess of 20%. And in security by design it was high single or low double digits because security has not experienced the types of volume declines and margin pressure as our two tools businesses. And as Jim just pointed out, in fact, we are in the process of trying to build for the future and maintain volume by adding 8% to our sales force -- which glass half full it should add 8% to our revenue, glass half empty would preclude an 8% further decline, depending on how you look at the business.

Jim Loree - *The Stanley Works - COO & EVP*

And that's an important point because we haven't factored in any volume associated with those reinvestments and surely at some point in the year they are liable to throw off some positive volume which would be a nice cushion against possible further market decrease.

Michael Rehaut - *JPMorgan Chase & Co. - Analyst*

Right. No. I appreciate that. Just as a follow-up, I guess, is what you were referring to before about the fact that organic only down 4% in such a difficult environment. If you could just remind us, give us your split for recurring revenue, what is that as a percent of the sales? And if possible that percent mix by CSS and MAS?

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

Mike, we have been public with that before and it hasn't changed. Roughly to the nearest tenth percentile, because we are not going to split decimals with you. On the Convergent side it's slightly in excess of 40%, and we are trying to grow it. And if nothing else as installs go down and we don't lose any customers, it will grow as a percent of total. But it's basically constant recurring on a lower base. On the mechanical side, it's about 20%. Those segments are almost identical in terms of size. So the math gets you to 30% in total.

Operator

At this time, there are no further questions. Ms. White, I'll turn the call back to you.

Kate White - *The Stanley Works - Director IR*

Thanks, everybody, very much, for their participation, and as I said at the outset of our call, our contact information is on the website and in the press release. And I wish everybody to have a wonderful day and weekend.

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

Thank you.

Operator

This does conclude today's conference call. You may now disconnect.
