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## SWK - Q4 2015 Stanley Black & Decker Inc Earnings Call

EVENT DATE/TIME: JANUARY 28, 2016 / 1:00PM GMT

**OVERVIEW:**

Co. reported 4Q15 full-year EPS of $5.92 and 4Q15 EPS of $1.78. Expects 2016 EPS to be $6.00-6.20.





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## PRESENTATION

**Operator**

Welcome to the Q4 and full-year 2015 Stanley Black & Decker earnings conference call. My name is Stephanie and I will be your operator for today's call. Please note that this conference is being recorded. I will now turn the call over to the Vice President of Investor and Government Relations, Greg Waybright. Mr. Waybright, you may begin.

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

Thank you, Stephanie. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's fourth-quarter and full-year 2015 conference call. On the call, in addition to myself, is John Lundgren, our Chairman and CEO; Jim Loree, our President and COO; and Don Allan, our Senior Vice President and CFO.

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

This morning John, Jim and Don will review our fourth-quarter and full-year 2015 results and our 2016 outlook followed by a Q&A session. Consistent with prior calls, we are going to be sticking with just one question per caller. And as we normally do, we will be making some forward-looking statements during the call.

Such statements are based on assumptions of future events that may not prove to be accurate and as such they involve risk and uncertainty. It is therefore possible that actual results may materially differ from any forward-looking statements that we might make today. And we direct you to the cautionary statements in the 8-K that we filed with our press release and in the most recent 34 Act filing. I will now turn the call over to our Chairman and CEO, John Lundgren.

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

Thanks, Greg, and good morning, everybody. Today we are going to spend just a few minutes reviewing a solid operational fourth-quarter that wrapped up a really strong year before we discuss this year's guidance and then of course take your questions.

First, for the year organic growth was up 6% with Tools & Storage leading the way up 8%, Security was flat while Industrial delivered 2%. Operating margin expanded 90 basis points to 14.2%, which is a post merger record for the Company. EPS of $5.92 was a 10% improvement versus 2014. Jim is going to provide a lot more detail, particularly on the margins and growth by segment, when he gets into the segment reviews.

Free cash flow came in at $871 million on strong working capital turns of 9.2. And in line with our previous commitments, we executed over $1 billion of share repurchase actions in 2015, wrapping up a really strong year in which we overcame numerous challenges, not the least of which was foreign-currency.

Guidance for 2016 is being established with an EPS range of $6 to $6.20 a share or a midpoint EPS growth of approximately 3% versus 2015. Don is going to take you through this in more detail later in the call.

Moving to the right on the chart, for the quarter revenue expanded 1% organically with total growth down 5% as the top-line impact of foreign currency was negative 6% for the quarter. There was a fiscal calendar phenomenon in the fourth quarter that did have a modest negative impact on organic growth that Don is going to address more in detail when he walks through the quarter. But I think it is an important point.

Operating margin rate for the quarter was 14.2% which was a 100 basis point improvement ahead of the fourth quarter 2014. Our margins increased due to continued sharp focus on price realization and some commodity deflation delivering operating leverage despite $50 million from foreign currency pressure in the quarter.

EPS of $1.78 was up 30% versus fourth quarter 2014 as the solid operational performance combined with lower tax, share count and some restructuring less than the prior quarter offset the foreign exchange.

Turning to slide 5 and an overview of the sources of growth. For the quarter, as previously mentioned, organic growth remained positive due to the continued strength in Tools & Storage, particularly in the US and the European residential and nonresidential construction markets, and the Stanley engineered fastening automotive business, which offset pressure in the Industrial channel, lower emerging-market volumes and customer specific volume declines within the Stanley engineered fastening electronics business.

This growth was offset by foreign exchange headwinds of 6% in the quarter resulting in total revenue down 5% as previously mentioned. Looking at it geographically, Europe led the way up 3% as share gains continued in the region and nearly every market contributed positive growth. The US generated 1% organic growth while solid construction POS performance has left customer inventories in good shape as we enter 2016.

Emerging markets and the rest of the world began to show signs of macro pressure to the top line, contracting 2% and 3% respectively. There was, as always, significant variation among the countries, but China, Russia and Venezuela showed the largest year-on-year decline.

And quickly for the year, organic growth was 6%, 5% volume, 1% price. This growth was offset by 7% currency netting down to a 1% decline in total revenue as shown in the box on the left of the chart.

We were pleased that geographically the organic growth we shared around the world spread fairly evenly, of course, with the US leading the way at plus 8%, Europe plus 4%, emerging markets plus 3% and the rest of the world plus 3%.

Let me turn it over to Jim to get into some more operating detail on our three segments.

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

Okay, thanks, John. I will start with Tools & Storage which wrapped up a banner year with solid fourth-quarter performance despite difficult comps, mixed end markets and a relentless dollar strengthening.

Tools benefited from strong execution momentum in all areas, new products, supply chain and commercial excellence. As for markets, continued strength in US construction, DIY and consumer was a help. However, emerging-market and overall industrial conditions were more than challenging.

European tool end markets continue to be flat to slightly positive and continuing US dollar strengthening, especially against Latin American currencies, presented familiar but increasingly large headwinds for both revenues and operating margin. Organic growth for the segment was 3% in the quarter. With all regions once again contributing Europe led the way, up 6% followed by North America and emerging markets contributing 3% and 1% respectively.

Although revenues were down 3% due to a 6 point currency impact, operating margin was up 1% with a 60 basis point year-over-year improvement in the rate. Execution of price, productivity and cost control initiatives, along with a little help from lower commodity prices, enabled us to more than offset the onslaught from currency pressure. And across the global product lines power tools posted 5% organic growth with contributions from professional power tools up 7%, consumer power tools up 3% and accessories up 2%.

Our hand tools and storage business was down 2% as strength within construction tools and our Mac mobile distribution business was offset by significantly lower sales within the Industrial channels. Innovation continues to generate solid growth across the business with ongoing contributions from DC brushless power tools as well as new product rollouts such as the DeWALT 20 and 40 volt outdoor, Stanley FatMax power tools in Europe and DeWALT pneumatics.

Within North America retail POS performance was again strong in the quarter wrapping up a record year which saw positive POS in 50 of 52 weeks, growth across every SBU and as impressively across all major brands, Black & Decker, DeWALT, Stanley and Bostitch. Importantly, retail inventories remain at healthy and appropriate levels consistent with prior year.

In addition, the team continues to drive outperformance in Mac Tools which closed the quarter with growth in high-single-digits delivering its sixth consecutive year and 24th consecutive quarter of year-over-year growth. And finally, we continue to enjoy robust growth in eCommerce, this time highlighted by success with our rebranded and very innovative Black & Decker consumer products.

Europe continues to perform at multiples above the underlying market, posting 6% organic growth in the quarter for a full-year total of 7%. This region has shown remarkably consistent share gains in a relatively flat market delivering approximately 7% organic growth across much of the past three years. Importantly the growth in Europe continues to be widespread across nearly all regions as consistent share gains validate the success of our innovation and commercial excellence initiatives.

The emerging market team once again overcame significant market headwinds generating 1% organic growth in the quarter with contributions from Argentina, Mexico and Turkey more than offsetting continued pressures in Russia, China, Brazil and other parts of South America. And meanwhile, the timely global release of the Stanley power tools line for emerging markets continues to gain traction in the large and growing mid price point segment, helping to offset regional economic and geopolitical market turbulence.

The fourth-quarter caps off an exceptional year by our Tools & Storage team, 8% organic growth for the year against a 6% 2014 comp with an operating margin rate up 110 basis points executing on all fronts, taking share, improving profitability in the face of a volatile backdrop. And at the same time the team very methodically and successfully positioned the business for more growth ahead.

In that regard we see continued robust growth for tools in 2016. Our innovation pipeline is stronger than any time since the merger and our supply-chain and commercial teams are operating at very high fitness levels with SFS 2.0 firmly embedded in our operating culture. These are exciting times for Tools & Storage and we expect the performance level to continue to be very high as we go forward.

Turning to Security, progress continued across our Security business with Europe advancing on all fronts and North America showing steady progress in its transformation efforts. Within Europe the business was up 3% organically, the fifth consecutive quarter in positive territory.

Commercial wins were widespread across most countries as we recognized benefits from investments in our regional sales organizations. Profitability continued to improve sequentially and versus prior year with a fourth-quarter operating margin rate approaching 10%. Solid order intake and a healthy backlog, both up double-digits year-over-year, combined with stable attrition rates within our targeted range leave us well-positioned to continue forward momentum into 2016.

While organic revenues were down within North America due principally to a large installation in last year's fourth quarter, the team posted sequential margin expansion due to improved field productivity within the commercial electronic security business as the benefits from the Stanley standard operational improvement initiative began to take hold. Strong orders, a healthy backlog and a growing RMR portfolio position this business well as we head into 2016.

Emerging markets were again a modest drag on security growth and profitability as weak market conditions in China continued, but overall for the segment profitability was up 100 basis points year-over-year and 90 basis points sequentially, a solid indicator that our transformation efforts are taking hold within the organization.

Turning to Industrial, Industrial saw a 1% organic decline in the quarter as lower volumes in Engineered Fastenings, Electronics & industrial businesses more than offset strong global automotive revenue and organic growth in our Oil & Gas business. Operating profit was up 5% with a 210 basis point improvement in the margin rate as productivity gains and cost controls were able to counteract lower volume.

Engineered Fastening's 3% organic decline was attributable to weakening within the Industrial channel and lower sales volume and the Electronic space as our largest consumer electronics customer unexpectedly reduced production levels on their recently launched smartphone. This more than offset another quarter in which our automotive revenues outpaced light vehicle production.

The business was able to anticipate some of the Industrial market softness and thus benefited from proactive cost actions taken within the quarter. Infrastructure delivered positive organic growth of 2% as Oil & Gas grew 17% organically propelled by increased project activity in the North America onshore market more than offsetting declines in hydraulics which continues to be impacted by depressed scrap steel prices.

All in all an impressive operational performance was registered by the Industrial teams, expanding profitability and margin rates in the face of a choppy and mostly inhospitable end market environment with the exception of auto production.

In summary, for the total Company the fourth quarter represented a solid performance wrapping up a tremendous year which included organic growth of 6%, record operating margins and record EPS. This performance highlights our team's agility, passion to perform and ability to be proactive and responsive to market conditions, balancing investments for growth and taking out costs when necessary, strengths that will serve us well as we head into 2016.

As we consider the 2016 outlook, which Don will share with you in a few minutes, our ability to generate outsized organic growth, albeit at a slower pace than in the preceding two years, will be enabled by the investments we have made and are making in SFS 2.0, which is our transformational business operating system.

In early 2015 we launched the next generation of SFS, creating a more powerful mechanism to enable sustained above market organic growth and margin expansion with high asset efficiency. The expanded SFS 2.0 is transforming the Company by focusing our activities in five key areas: digital excellence, breakthrough innovation, commercial excellence, functional transformation and core SFS.

I would encourage serious long-term investors to develop a deep understanding of SFS 2.0 in that this is not an Investor Relations marketing jargon, but rather a carefully constructed and executed framework that enables our organization to extract maximum value out of our world-class franchises. We do this through capital efficient organic growth and continuous margin expansion.

You have already seen the manifestation of commercial excellence in the organic growth and margin expansion in Tools & Storage and other parts of the Company. In 2016 you will see a growing impact from breakthrough innovation, digital as well as the other elements of the initiative which is now in its second year and gaining momentum.

I would also say that we are once again open for business when it comes to inorganic growth. We look forward to supplementing our organic growth with a disciplined approach to M&A that we have deployed during almost 100 acquisitions over the past 15 years, a period of time when we more than quadrupled our revenues and market cap and outperformed the S&P 500's total shareholder return by five times.

With that I will turn it over to Don Allan.

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

Thank you, Jim. Let's begin with our fourth-quarter and full-year free cash flow performance. Free cash flow in the fourth quarter totaled $697 million, up almost $50 million from the prior year, resulting in $871 million of free cash flow for the full year.

This full-year result is approximately $50 million to $75 million lower than we anticipated going into the quarter and is the result of lower than expected fourth-quarter volumes in Tools & Storage and Engineered Fastening, which in turn resulted in lower working capital liquidations. Nonetheless, working capital turns finished the year at 9.2 times, flat to the prior year, but at a level that many industrials would envy. Overall our cash flow performance remains strong, a 96% conversion rate for the full year and our leverage metrics are in line with our year-end expectations.

One additional comment on free cash flow as it relates to the Other line. As you can see, we experienced approximately a $120 million variance versus the prior year in the fourth quarter. This variance was planned and is due primarily to discontinued operation activity in the fourth quarter of 2014 combined with the timing of certain derivative settlements and tax payments.

So let's turn to page 11, I would like to provide you with an updated outlook on our 2016 foreign exchange headwind. Certainly it won't be news to anyone that the US dollar has continued to appreciate against the vast majority of currencies around the world.

This strong dollar has resulted in approximately a 50% increase against the Brazilian real since the beginning of 2015. Also the British pound and the Australian dollar are at levels we have not seen since the 2008 credit crisis and the Canadian dollar has not been this weak versus the US dollar for well over a decade.

And last but certainly not least the Argentinean peso, which essentially has been on a constant decline since the government's default back in 2001, accelerated its correction with a 30% cliff devaluation in December resulting in another meaningful headwind for us in 2016.

The effect of all of these moves is that we are facing another significant foreign exchange headwind in 2016, which at current spot rates results in a year-over-year impact to operating margin between $170 million and $190 million. This impact is a combination of transactional and translational.

However, approximately two-thirds of the 2016 headwind will be transactional, pressuring our margins, while approximately one-third will be translational. The transactional amount is substantially higher than prior year as we feel the impact of the 2015 derivative hedges expiring in 2016 and this is approximately $60 million of our total currency headwinds.

This 2016 currency impact is on top of over $300 million in currency headwinds we faced over the past two years, where our teams focused on significant operational actions which more than offset these pressures in 2014 and 2015. However, given the magnitude of these continued headwinds, we will not be able to completely offset currency in 2016 with price and cost actions. That being said, we will offset approximately 50% of this $170 million to $190 million headwind within 2016.

And as we have previously discussed, over the long term we will continue to identify opportunities to localize production to help mitigate currency as well as improve the efficiency of our global supply chain.

So let's transition to our 2016 outlook on the next page. As John mentioned, we are guiding to an EPS range of $6 to $6.20 or a mid-point EPS growth of approximately 3%. Let's walk through some of the key drivers in our guidance.

First, we expect organic growth to approximate 3%, which will contribute $0.45 to $0.50 EPS for the year. As Jim discussed, SFS 2.0 will help fuel this growth in 2016 and beyond. We expect our tools and storage business to continue to take market share in most regions.

Our innovation pipeline is robust and we believe this business can leverage that to grow in the low- to mid-single-digits in the face of a challenging global macroeconomic environment. We expect progress to continue within the Security platform resulting in low-single-digit growth and we also expect Industrial to have low-single-digit growth as the Engineered Fastening Automotive business will continue to demonstrate strong growth while the remainder of the segment faces pressures across several end markets including Oil & Gas, Scrap Steel, General Industrial and Electronics.

One additional point related to organic growth before I move on to the next topic. It is worth noting that when normalizing for a 53-week activity, which was included in 2014's fourth quarter, which is the fiscal calendar phenomena that occurs every seven years. If you adjust for that the total Company's organic growth would have actually been 1.5 to 2 points higher or approximately 3% in the fourth quarter of 2015.

This is notable when you consider the fact of 1% organic growth and us guiding to 3% organic growth in 2016. We believe this along with the strength of certain markets we operate in, namely US Construction along with global Automotive production, combined with our focus in SFS 2.0, gives us confidence in our ability to achieve 3% organic growth outlook for 2016.

Continuing to the next EPS driver. We will see another $0.45 to $0.50 of earnings improvement from additional cost and productivity initiatives. We have a solid amount of carryover commodity deflation materializing in 2016. And the business teams have worked hard to identify additional cost reduction opportunities, which on top of our normal productivity gains will result in a solid contribution to the bottom line.

Also we see an additional increase to EPS of approximately $0.13 from a lower share base due to the carryover benefits of our 2015 share actions as well as opportunistic buybacks, particularly if we continue to see depressed share prices. Working against all of these strong operational actions will be the previously mentioned foreign exchange headwind, which results in approximately $0.85 to $0.95 of EPS pressure year-over-year.

Because of the severity of this transactional currency headwind, and its impact on margins, we expect the companywide operating margin in 2016 to be relatively flat year-over-year. To put this in perspective, we estimate that the FX headwinds, net of benefits we are receiving from lower commodity costs as well as pricing activities, will cause us to lose 60 to 75 basis points of margin rate improvement in 2016.

Our three-year financial vision presented at the May 2015 investor meeting contemplated a 50 to 75 basis points of margin improvement each year, which assumed a stable foreign exchange environment. So we believe we are continuing to perform in-line with that objective, albeit with our improvements offsetting FX rather than resulting in OM rate expansion as we would like to see.

A few other items to mention related to guidance are -- we expect our restructuring charges and tax rate to be relatively flat to the prior year. And then finally, as we look to the first quarter we expect our first-quarter EPS percentage of the full-year EPS to be approximately 18.5%, which is very close to the prior two years' average.

Moving to the segment outlook on the right side of the page, I have already touched on most of the drivers behind our organic growth, so I will spend a minute on margin rate expectations. We expect Tools & Storage margin to be relatively flat year-over-year and that is primarily the result of the FX dynamic I described earlier netting against the really impressive operating leverage this business continues to achieve.

We expect Security margins to continue to improve modestly versus prior year affecting benefits from further progress in field productivity, our commercial investments and the realignment of the cost structure of the business to help drive profitable future growth. Another good step forward is anticipated.

Industrial margins are expected to be relatively flat as productivity gains and cost takeouts, particularly within the Engineered Fastening business, are expected to offset top-line pressure I previously discussed related to key portions of the segment.

Before moving on to the summary of this morning's call, I would like to discuss the potential for a recessionary environment and make a few comments on what actions we would take if -- and I emphasize if -- we are faced with deteriorating economic conditions.

At this stage we believe a US recession is low probability in 2016. However, we have established contingency plans to ensure we are adequately prepared. If we were faced with this type of an environment, consistent with our behavior in past similar circumstances, we would execute mitigation plans and they would take the form of headcount reductions, investment delays and further discretionary spending reductions.

Specifically, if the environment resulted in us experiencing a flat organic revenue performance versus our current view of 3% growth, we would take cost actions to hold EPS relatively close to our guidance range. Clearly if a more severe environment were to occur, which appears unlikely at this stage, we would focus on protecting our earnings base as much as possible, similar to the approach we took in 2009.

Now moving on to the summary page. We are very pleased with the business' performance in 2015. We witnessed strong operational execution overcome a host of external challenges, including: $220 million of foreign exchange headwinds, which delivered ultimately organic growth of 6%, at the top end of our targeted range; a record operating margin rate of 14.2%, which was up 90 basis points versus the prior year; and of course double-digit EPS growth.

We are also encouraged with the progress in our Security business, particularly Security Europe, which really made meaningful improvements on all fronts. As we look to 2016 we are focused on positioning the Company to manage through another year of turbulent markets and severe foreign exchange headwinds.

As such we remain committed to our core objectives: maintaining our focus on organic growth through both continued innovation and commercial excellence; ensuring progress within the Security segment to maintain the momentum we saw in 2015; of course executing on additional cost and pricing actions to help partially offset our FX headwinds; and also being prepared to take further actions as conditions warrant; as always, maintaining our perpetual focus on working capital management and improving that as we move forward; and importantly, leveraging the pillars of SFS 2.0 and to continue driving momentum in 2016 and beyond.

That concludes the presentation portion of the call. Now we move to Q&A.

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

Don, thanks. Stephanie, we can now open the call to Q&A, please.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). Nigel Coe, Morgan Stanley.

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**Nigel Coe** - *Morgan Stanley - Analyst*

Just one question in line with the rules. Obviously the Tools & Storage performance in 2015 was exceptional. A big part of that was SFS 2.0 and the innovation pipeline. I am just wondering how does the NPI look for 2016 and maybe just comment on the share gains in Europe, any categories to call out there?

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

Sure, it is Jim. The innovation pipeline for Tools & Storage is as robust as it has been at any time since the merger. And while we have been focusing on -- if you rewind to 2010 when we put the companies together there was a lithium ion problem, they were losing share. We inherited that. Fortunately they had done a fair amount of corrective action that began to manifest itself shortly after the merger and we started regaining share.

And then we, after that -- a year or two of that really came out strong with the DC brushless, a complete redesign of the DC brushless products and that became the fastest growing segment of cordless and we became -- we were growing at about 2x and still are growing at a very rapid rate vis-a-vis competition.

And then at the same time there was a lot of incremental -- call it incremental innovation going on in hand tools and storage and the revitalization of the Black & Decker brand and product lines, the consumer products and accessories as well. So there has been a lot of I will call it broad-based but relatively small-scale innovation in addition to the lithium ion gains and then the DC brushless gains. So that is all really what has driven -- the NPI that's driven some of the growth here in addition to the commercial excellence that you referred to.

Now what is coming is something more on the order of breakthrough innovation which is the real SFS 2.0. And without getting into the details of exactly what it is, I think if you stay tuned during 2016 you will start to see some pretty interesting innovation that would be more in the category of breakthrough. And in addition to that we will continue on with the incremental type innovation in the DC brushless and the continuing progress and lithium-ion.

So it really is a step function increase in innovation that is occurring in the tools business and you will start to see the manifestation of that I think in the second half of the year.

As far as Europe, there is a number of things going on in Europe relative to the Black & Decker products, the consumer business, the brushless, which is a big deal over there, and a number of other things. But I would say Europe is a combination of the NPI, plus just a tremendous thrust into commercial excellence, which as we have described it -- or has we describe it involves a multi-pronged attack into the seven pillars, if you will, of customer facing processes, which include gaining customer insights, driving innovation, driving brand awareness, being excellent at pricing and promotion, deploying the sales force properly, doing channel and partner programs that are very aggressive and successful.

And then finally providing outstanding customer sales and post sales support. And it is a focus on all those various processes. When you put them all together that is what is really driving the growth in Europe. And I would say on top of that you have what I'll call second order revenue synergies from the Black & Decker merger that are even today manifesting themselves in further growth -- customer whitespace, distribution channel whitespace, those types of things, brand whitespace are all helping drive the European growth.

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**Operator**

Shannon O'Callaghan, UBS.

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**Shannon O'Callaghan** - *UBS - Analyst*

In terms of Tools & Storage, the outlook for US construction is still positive -- maybe there and just for the broader Company that we are getting this offset now from Industrial. Can you sort of frame and provide a little more color on the magnitude of the drop off you saw there in 4Q? And what are your expectations for the drag from Industrial in 2016?

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

Hey, Shannon, this is John. Industrial markets are slowing down, that is the bad news. The good news is it represents about 20% of our total business, 25% I guess with Industrial hand tools within Tools & Storage. But if I can kind of address I will say the elephant in the room where you are very polite or diplomatic about it, but I think I can answer your question quite helpfully.

We strive to grow at two times the rate of the market in our Tools & Storage business over the long term. And we have met or exceeded that objective over the past two years, as Jim just described, as the SFS 2.0 growth initiative started to gain traction. And this being said, I don't think it is realistic to plan such outsized growth each and every quarter from any global diversified industrial.

So in the fourth quarter organic growth was lower than we planned, but the shortfall was in areas you would expect. And a lot of information from Jim and Don, but to try to summarize it, we did have lower Industrial channel volumes in Tools & Storage and Stanley Engineered Fastening, that was a full point of organic growth relative to our expectations. And that is globally across the Company.

Another full point was lower customer specific volumes and it has been well in the public domain from a large consumer electronics customer for our Stanley Engineered Fastening business, again within the Industrial segment. But that contributed almost a full point of slower organic growth than our expectations.

Something that is not directly related to Industrial channels, emerging markets softness, if you will, contributed about a point. So relative to the 1% reported, that is about 300 more basis points. And then lastly, Don talked about the fiscal calendar phenomenon which was another 100 to 200 basis points.

So looking at it all that way I think it is fairly straight forward. Without question the biggest headwind being Industrial markets in general and those markets in the US in particular because they have been so strong.

Conversely, as Jim just talked about, Tools & Storage in the US up mid-single-digits, Europe up 6%, but that is driven by construction and retail, even eCommerce which was way up. Automotive is still strong, we grew 6% in the fourth quarter, which is well above the rate of light vehicle production. And Security Europe, our investments are paying off, it was up 3%.

So, I think your question is spot on, our biggest headwind on organic growth obviously, because that has nothing to do with FX, are the Industrial markets they represent 20% to 30% of our business. And if they are flat we think -- the markets are flat we think that is probably as well as they are going to do. I think you can do the math from there. So I hope that helps.

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

And if I could just offer a little additional insight on the Industrial. It is an interesting situation because you have very much a sector specific series of issues with agriculture, mining and oil and gas or energy. So there is a capital -- CapEx kind of contraction going on in those industries and it has sort of spilled over to affect the overall MRO market as well.

And then you have Industrial markets such as automotive that are more driven by consumer demand. And those are relatively healthy. So within Industrial you have a dichotomy of markets that are flat out on their back and then you have other healthy markets.

And fortunately for us a good portion of our Industrial exposure happens to be in the automotive, and if that holds up that will be a very good thing. And we will just see how long it takes for this ag, mining and energy, those segments to kind of play out and trough out and then at that point I think we will be back in good stead within Industrial.

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**Operator**

Mike Dahl, Credit Suisse.

**Unidentified Participant**

Hi, this is Matt on for Mike, thank you for taking the question. Just wanted to ask on the Engineered Fastening business, wanted to get your thoughts on the customer challenges you mentioned, just on the electronic side specifically. So how you may be addressing that, how you think that dynamic plays out in 2016 and how that is embedded in your organic guidance?

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

Don will give you exactly how it is embedded in organic guidance because it is pretty much arithmetic. But as you would expect, it is a large customer, we don't -- we just have a policy not to mention customer's names on our call. But I think it is quite clear who it is and that is their choosing, not ours.

That being said, strategically it is to diversify our customer base. Just as we have done over the years in global Tools & Storage where there was a point in time where the two largest North American big-box retailers represented 40% of our business. Today they are huge customers, but they represent about half that amount.

The same thing with Engineered Fastening and then I will turn it over to Don. Less than three years ago OEM automotive was more than 70% of the business. So it was a conscious decision to diversify the verticals we serve particularly with a focus on electronics, to a lesser extent aerospace. And we have done that and it has been pretty successful.

So we've had tremendous growth and a step back relative to one customer's end market product sales being down. Simply said, within consumer electronics we need to diversify our customer base. We think we have as good a product offering as anyone to accomplish that, of course it doesn't happen overnight. And then continue the strategic push, as Jim and the business leaders talked about in May, to serve more verticals. But Don can talk to you about the specifics of one issue in consumer electronics as it relates to our guidance.

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

Our electronics business within Engineered Fastening, as John mentioned, was down substantially in the fourth quarter. It had an impact of a full point across the entire Company, which equates to about $25 million of revenue. And that was a percentage decline versus prior year of close to 30% to 40% with that particular piece of the Engineered Fastening business.

We expect that type of pressure to continue into 2016 and we formulated that into our guidance and that is certainly one of the pressure points that we are anticipating and it is a headwind against the organic growth of 3%. And so, it is one of the reasons why the organic growth is at that number versus maybe the original expectation of closer to 4%.

**Operator**

Tim Wojs, Baird.

**Tim Wojs** - *Robert W. Baird - Analyst*

I guess my question is just on construction. Curious what you are seeing in the market and kind of what you are embedding around non-res and residential construction in 2016.

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

I will take that one. We obviously have a few that is positive related to construction overall. And we think that is an appropriate perspective for 2016 at this stage. And when you look at point-of-sale information from some of our major customers we are seeing rates that -- we ended the year with very strong growth rates than what we are seeing and expect that to continue here in 2016.

As far as the break between resi and non-res, I think the non-res market continues to show a little bit of life. We watch that closely in our -- a portion of our Security business, in particular our mechanical lock business is a good indicator of that. That business is demonstrating kind of mid- to high-single-digit organic growth over the last year. We expect that type of trend to continue.

So, we are not looking for a dramatic increase in that space, but it is a relatively small part of our Company, roughly $250 million to $300 million of revenue annualized. But it is a good indicator of the non-resi market.

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**Operator**

Jeffrey Sprague, Vertical Research Partners.

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**Jeffrey Sprague** - *Vertical Research - Analyst*

I wanted to come back to currency more from a strategic standpoint if you could kind of address kind of the question. Looking at what is going on, obviously there could be a debate on whether this is now just a cyclical phenomenon or a secular phenomenon. And I just wonder where you stand on that.

And really the essence of my question is, if you believe it is more secular what does the investment look like to further reposition the footprint of the Company geographically to respond to that on a longer-term basis?

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

Yes, I will start, Jeff. You used the caveat if you believe it secular, and I am not sure we do. We could have a long debate about it. But even if -- we are going to do the same thing irrespective cyclical or --.

On cyclical, Jim, Don and I have been doing this a long time if we just want to talk about the euro, everybody worries about it being at parity. I have done business when it was at $0.85 and we have seen it approach $1.50. That is fairly cyclical.

Irrespective whether it is cyclical or secular, what we can do the most, I think two things. We are not going to double down where the risks are high, but we are also not going to walk away from our investments. We are going to stay positioned particularly in emerging markets and 50% of our revenue is outside the US in those markets which will continue to grow albeit slower from a lower base -- to be in a position to leverage our share and leverage our volume when and if it turns around.

But the biggest thing affecting us, and I think Don touched on it, we always talk about both translational and transactional. And as the transactional aspect grows to more than 50% of our foreign-exchange headwind, what we are working very hard to do is move production and sourcing locally.

We have a goal to produce 50% or more of what we do in countries where we sell it. And if you take that to the next step, obviously you know that -- everyone knows you can't build a plant overnight, nor would you want to, nor would you want to put bricks and mortar down if you believe it is secular.

But what we can do is a much better job, and we are working hard at it, qualifying local both raw materials and, more important, critical component suppliers. And if you are working in an emerging market, as I think you are aware, many of our components that are critical to quality are either US based or US produced or dollar-denominated.

To the extent we can qualify local suppliers, protect our IT, but produce those critical components locally -- to be processed locally, that is going to be a tremendous offset or hedge. Don may want to add something to that.

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

Yes, I think, in that particular point, what John said is exactly correct. However, the reality is at this stage in certain parts of the world, Canada and Brazil being the best example, there is not a great deal of suppliers that are available that we can do that with.

So that is something that we have to think about, is there an Asian company that we are currently working with that they could create a plant within Brazil and allow us to have a supplier locally that is transacting locally. Those are all things that take time. These are not necessarily things that happen overnight.

In the meantime we are doing things as much as we can that make economic sense over the short term and the long term. But I think we do view this as very much a cyclical shift. And if that view changes over time then obviously our view of where we manufacture will have to shift as well.

Because if you look at the history of Stanley, and of course the history of Black & Decker separately, they are both known for pursuing the lowest cost possible and also maintaining the highest quality. And that is not going to change. So as dynamics shift in the markets around the world and costs shift with it we have to be flexible and agile to make sure that we are doing the right thing from a supply-chain perspective.

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**Operator**

Rich Kwas, Wells Fargo Securities.

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**Rich Kwas** - *Wells Fargo Securities - Analyst*

Two quick questions. One, John, what are your thoughts about asset prices now for potential acquisitions in terms of what you are seeing out there given some of the broader weakness in the global economies?

And then second question, on Industrial margin I think calling for relatively flat, Don, does that assume a -- how much of a decline does that assume in electronics? It sounds like you are assuming a pretty steep decline year-over-year within the guide. But just wanted to get the puts and takes and the risks to upside or downside to the Industrial outlook for margin. Thanks.

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

I will take the asset price. They are becoming more reasonable just as is Stanley Black & Decker. As -- I think Jim could not have been more clear in his pitch, Rich, that we are open for business in terms of growing this Company by a thoughtful, strategic acquisition that meets our -- both our strategic goals and our financial hurdles as well as fits within our organizational capacity.

And I will simply say, as multiples come down I think and valuations come down there is more out there that could be attractive to us both domestically and outside the US. I don't think there is so many bargains out there as we speak that we need to rush to buy something because it is never going to be at a lower price. But our view was always to buy good companies at a fair price.

We have had a hard time meeting or exceeding valuation expectations in the last six months. But we see it, I think as you might expect, coming more into line, which is that and the fact that we think we have our Security business on the right track which is why Jim made the point in his piece of the presentation. We are open for business, looking at assets in the three strategic areas that we have previously identified.

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

And, Rich, and on the Industrial question related to margin, certainly the impact from the electronics business within Engineered Fastening is pressuring margins as we expect significant top-line pressure there. We also within that business, within Engineered Fastening we have kind of a general Industrial sector that is about $0.5 billion in revenue on an annualized basis that has been feeling pressure as well similar to the Industrial tools business within Tools & Storage.

And for example, in the fourth quarter that business was down approximately 10%. And we expect that to continue at least into the first half. So those two things are definitely putting pressure on the top line and the margins.

Now offsetting that and going in the opposite direction is what Jim and John had mentioned about the automotive production business within Engineered Fastening is offsetting that we expect growth probably in the mid-single-digits again within that business in 2016. And we also have cost actions and various other productivity actions we are taking across Engineered Fastening to make sure that the margins are flat and hopefully a little bit better than that as the year goes on.

And then the two smaller pieces of Industrial, which is the Oil & Gas business and the Hydraulic Tool business combination, what we call Infrastructure, we expect those to be relatively flat on the top line, maybe down slightly, and then margins flat as well as those markets are pretty slow at this stage. But we think we have gotten through the difficult comps as we go into 2016.

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**Operator**

Robert Barry, Susquehanna.

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**Robert Barry** - *Susquehanna Financial - Analyst*

Was wondering if you could just talk a little bit about what is assumed for price in the outlook. And specifically perhaps if you could unpack some of the moving pieces, say price to offset currency, price to get paid for all the innovation versus maybe having to share some of the commodity deflation with the bigger customers? Thanks.

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

Fair question, fairly complex to say the least.

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

Not sure I can give all that level of granularity, but for a variety of reasons. But I will give you a little bit of color on this area. We do expect a modest positive in price in 2016 and there is really a makeup within that number. We do see more positive price in emerging-market action. So as we deal with this currency pressure in particular in Brazil and some of the other Latin countries, but then also in Canada as well which is obviously not an emerging-market, we expect some price increase there.

So those are positives. Some of the negatives -- we will see a little bit of price pressure in different parts of the mature markets. As we have dealt with some significant commodity deflation, that has been a benefit to us. We don't expect that to be significant, but those are very kind of surgical strategic decisions that our Tools & Storage team is very savvy at managing and working through as part of the overall offering to our customers.

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

Yes, I guess I will just add to that; I think it is important because the very end of your question was more than fair in terms of getting paid for the innovation. We have a history of, if you will, protecting price or being paid by innovation just for that reason. Specifically to bring the same product or a minor modest incremental improvement to a customer even in a flat commodity situation and expect the price increases, unrealistic to say the least. Real prices have been declining 2% to 3% a year, or 1% to 2% a year for the last 10 years, real prices.

So the way to protect price, and I think it is probably more important to understanding why Don has confidence that overall we will see some modest price, is to bring in some cases meaningful -- incremental but meaningful and in other cases, to Jim's point, breakthrough innovation to the customers. If no one else has it you can charge whatever -- you can value price and charge what you believe is appropriate for it.

So it is far easier to bring a product improvement at a 5% or 6% higher price point. That way you cover your inflation, your labor inflation or anything else that there happens to be there, the incremental cost of that improvement. And you and the customer both win because the customer can take his retail price up, you can take your wholesale price up and thereby protecting margins and everybody wins and it is a fair trade.

**Operator**

Stephen Kim, Barclays.

**Don Coil** - *Barclays Capital - Analyst*

Hey, guys, it is [Don Coil] filling in for Steve. Can you maybe talk about the pace activity over the course of the quarter? Did you see a deceleration as we got later into the year? And then maybe any thoughts on what you have seen thus far in January.

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

Yes, this is Don. I would say that we didn't see anything that was really indicative of significant market trends. When it comes to our retail business in Tools & Storage there is a lot of ebbs and flows in the quarter that are really dependent on when customers want product, refilling orders after the holiday season. So from a general market trend we didn't see anything dramatic within the consumer side aside of Tools & Storage.

On the Industrial side it was pretty much a consistent trend throughout the quarter other than electronics. Obviously electronics shifted to the negative dramatically in the month of November and that held into December and it is holding into the first quarter.

So we are not necessarily taking anything as far as market trends in the fourth quarter as a big indicator to the first quarter and beyond, beyond some of the things that we have already discussed such as electronics and general Industrial. But I think the only thing that really shifted within the quarter would have been the electronics business with Engineered Fastening.

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

Yes, and the only thing I will add to that that I think most of us are aware of as it relates to our retail customers and the retail business in general, one of the reasons Don said that between 18% and 19% of our earnings take place in the first quarter. January is always a very slow month. As I know you understand, most people on the call do, our largest customers' fiscal years end in January. It is post-holiday season. They have a very appropriate objective of reducing or minimizing inventories as the year closes.

So simply said, whatever happens in January we don't ever think of it as a good predictor or indicator of how the year is going to start. We need pretty much a full first-quarter, particularly on the retail side, for that reason to get a flavor for where we are or where we are going. Importantly

Jim pointed out, I think most important, POS was good in the fourth quarter, so inventories are in a good place. So nothing to suggest dire straits, but it is very early days.

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**Operator**

Mike Wood, Macquarie Securities Group.

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**Mike Wood** - *Macquarie Research - Analyst*

Can you talk about the progress you made in North America Security margins related to the vertical markets learning curve? And where are you -- maybe just give us an update on the evaluation of the overall security portfolio within Stanley. Thanks.

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

I will answer the second question first. And nothing has changed since we communicated in May of last year at our investor meeting that we would be doing an evaluation that would take about a year and that we would, during that period of time, we were going to evaluate the operational performance as well as the strategic issues and opportunities related to the security business and then we would come out with some sort of a position in the middle of 2016. And that continues to hold.

As far as the North American Security business, I think we are finding that in the verticals, the healthcare vertical is doing absolutely fabulously, it has achieved mid-double-digit margins, mid-teens and is -- issue with that now is how to grow it faster. So we will be making some investments to grow it faster and it could be a substantial contributor to organic growth.

The retail vertical I think is still kind of in the early days in terms of trying to figure out exactly where the value proposition can be and how big we can make that, how profitable it can be. And so, I would say we are probably in about the third or fourth inning with the retail. But I would expect by mid to late 2016 we would make a lot of progress on that front as well.

I think the other verticals -- those are the two verticals that we are going to be empathizing this year and really get them right, get the healthcare one growing, get the retail strategy fully engaged. And then at that point we will decide if we want to add another vertical to our main area of focus.

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**Operator**

Jeremie Capron, CLSA.

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**Jeremie Capron** - *CLSA - Analyst*

Congrats on a very solid year. I wanted to ask you, Don, about the free cash flow. I mean it has come in somewhat below initial expectations a year ago. And wanted to understand what exactly drove the shortfall here. I suspect ForEx trends were a significant contributing factor here. And so I am wondering if we should expect even more of a headwind on cash flow in 2016 given the transactional effects that you called out earlier. Thanks.

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

Sure. Yes, I mean as I mentioned in my comments, the free cash flow for 2015 came in a little bit lighter than we anticipated and it was primarily due to less working capital liquidation as a result of the lower organic growth that we saw in the fourth quarter.

And it is interesting, the timing of how it played out is usually what happens in our Tools & Storage business in particular is that we have high levels of revenue in October and November preparing for the holiday season as well as doing kind of refill orders after Black Friday. And then we collect a lot of that by the end of December.

Because we saw a different trend occur in that particular business, and obviously a lower organic growth number than our expectation, the result was that we didn't get the working capital turn that we were anticipating. We were anticipating turns of 9.5 to 9.7 that came in at 9.2 which are actually fantastic. And at this stage working capital turn improvement becomes harder and harder.

The other dynamic is as we grow organically, and you saw the significant organic growth we had in 2015, you have to improve your working capital turns even more to get a cash flow benefit. So even with -- if we had achieved an improvement to 9.5 or 9.7 we still would have had a slight negative within our cash flow statement for working capital. We would have had to get it much closer to 10 to see a positive.

And that is just the reality of what we are going to deal with going forward, that we won't see large working capital benefits in the cash flow statement. And we want to continue to improve working capital and get it over 10 turns over the next few years. And hopefully as we do that the amount of impact to cash flow will be modest. But it likely will be modestly negative.

As a result our cash flow on a go-forward basis will still be very strong. As I said for 2016, I expect the conversion rate to be about 100% which would mean it is going to be somewhere between $900 million to $925 million for 2016.

We always look to improve our working capital more than beyond our goals and expectations. So obviously we will be driving to try to outperform that. But right now, based on where we are with our working capital turns, we can't expect large cash flow benefits from that area. And really the cash flow is going to come from the earnings performance and operational performance.

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**Operator**

That concludes the Q&A session. I will now turn the call back over to Greg Waybright for closing remarks.

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

Great, thanks, Stephanie. We'd like to thank everyone again for calling in this morning and for your participation on the call. And obviously please contact me if you have any further questions. Thank you very much.

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**Operator**

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

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