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SWK - Q1 2016 Stanley Black & Decker Inc Earnings Call

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OVERVIEW:

Co. reported 1Q16 YoverY total revenue growth of 2% and diluted EPS of $1.28. Expects 2016 EPS to be $6.20-6.40.

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PRESENTATION

Operator

Welcome to the first-quarter 2016 Stanley Black & Decker Incorporated earnings conference call. My name is Kaylee and I will be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded. I will now turn the call over to Vice President of Investor and Government Relations, Greg Waybright. Mr. Waybright, you may begin.

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

Great. Thank you, Kaylee. And good morning, everyone and thanks for joining us for Stanley Black & Decker's first-quarter 2016 conference call. On the call, in addition to myself; 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. And 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 first quarter 2016 results and various other matters followed by Q&A session. And 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's therefore possible that actual results may materially differ from any forward-looking statements that we might make today. We direct you to the cautionary statements in the 8-K that we filed with our press release and in our most recent 34 Act filing.

With that, I'll now turn the call over to our Chairman and CEO, John Lundgren.

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

Thank you, Greg. Good morning, everybody. Thanks for joining us and for those of you who have had a chance to look at our earnings release, it should point out that we remain strongly focused on generating above-market organic growth, meaningful operating leverage, and strong free cash flow conversion.

We've really got a lot of really good news to report on the quarter as well as some real excitement looking forward. So I'm going to be very quick through some of the highlights before turning it over to Jim and Don for more granularity and then of course, we will get onto the Q&A.

Organically, we grew 5%, total growth of 2%, the difference being currency. Really robust organic growth in Tools & Storage 8%, with significant outperformance in the emerging markets, which was nice to see that come back 9%. Jim will give you a lot more detail on the strong Global Tools & Storage performance in just a second.

Industrial was down 3%, as we anticipated, and Security was up 1%, as the positive organic growth in Europe continues. It is a trend that we have been very focused on and we are very pleased to see it carrying on the way it has.

Operating margin rate of 13.1% was 20 basis points below last year; the overwhelming majority of that was the impact of $35 million of currency pressure. Security and Industrial operating margin rates were up 110 basis points and 120 basis points, respectively, and Tools & Storage was down slightly in the face of the currency headwinds. As most of you were aware, the overwhelming majority of our FX does -- impacts our Global Tools & Storage business.

That led to diluted earnings per share of up 20%, $1.28, up 20% versus prior year. Solid operating performance, combined with lower share count and lower restructuring cost, which more than offset the currency impact. So on the back of the first quarter performance -- outperformance, we're raising 2016 outlook for EPS to a range of $6.20 to $6.40, which is up 5% to 8% versus 2015 and up from our $6 to $6.20 range that we most recently provided. Concurrently, we are reiterating free cash flow conversion of approximately 100% of net income.

Let's turn briefly to the sources of the growth during the first quarter. Volume was up 4%; price was up 1%, leading to the 5% organic growth that I already touched on. Currency was at 3% offset so a total revenue growth of 2%. This compares to 1% organic growth and a 5% currency-driven revenue decline in the fourth quarter 2015, so very, very strong sequential quarterly trend.

Turning to the regions, you can see that all markets contributed. The US was up 6%; Europe, up 3%; total emerging market group was up 3%, which, of course, was led by Global Tools & Storage, with a very strong performance; and the rest of the world was up 1%. So all in all, a really solid first-quarter growth performance, with strength across virtually every business and in virtually every region.

So let's let Jim get into some of the details on our three segments. There's a lot of really good news this morning.

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

Okay, thank you, John. I will begin with our Tools & Storage business, which as John indicated, started the year off with another strong showing, once again, hitting on all cylinders and growing a robust 8% organically in the quarter against a 1Q 2015 comp of 10% growth.

The Tools team continued to outperform the market globally, as commercial excellence initiative, supply chain efficiency and a laser focus on innovation and new product development translated into market share gains across product lines and around the world. This is being accomplished against a volatile macroeconomic backdrop, characterized by large and unpredictable swings in foreign currencies, geopolitical unrest and anemic global GDP growth.

Total Tools revenue growth was 4%, after absorbing a 4% currency headwind. Currency also impacted operating margin, more than offsetting volume leverage, price and modest commodity deflation, resulting in a 40 basis point decline in the year-over-year operating margin rate. The consistency of organic growth across the regions and SBUs was particularly impressive, with North America leading the way, up 10%, followed closely by very strong emerging markets at 9%, and Europe with a solid 5% growth performance.

Regarding the Global Tools & Storage SBUs, power tools posted 10% organic growth with its underlying product lines, professional, consumer and accessories, each individually generating 10% growth. The Hand Tools & Storage business delivered a solid performance as well, growing 5% organically with MPD and healthy end markets fueling 10% growth in construction hand Tools.

Automotive Repair and Industrial was a mixed bag, with continued robust performance and MAC Tools, a flattish Facom more than offsetting anticipated but slightly better-than-expected negative pressure in North American industrial channels. SKU placement success stories were widespread with our new Porter Cable Cordless Nailer gaining listings in multiple outlets, gains with our Mechanics Tools and MAC high access ratchets and continued momentum within the DeWalt DC Brushless and Pneumatic Products.

Within North America, the retail channel posted double-digit gains, as strong POS performance was driven by supportive construction, and DIY markets, a mild winter especially compared to 2015, and pervasive new product introductions as well as continued share gains from DC Brushless and the Made in USA initiative. Targeted conversion efforts and promotional wins led to high single-digit growth in the commercial channel while a successful MAC Tool Fair helped offset aforementioned pressure in the industrial channels which remained down albeit with sequential improvement in the quarter.

Turning to Europe, which was up 5% organically, the story continued, with nearly all geographic markets again posting positive performances. Share gains, coupled with surgical pricing actions, delivered above-market growth as SFS 2.0 commercial excellence activities continued to take hold. The e-Commerce channel was another highlight, as innovations in our Consumer Products Group and the implementation of a broader and deeper go-to-market approach generated significant year-over-year gains.

Last but not least, the emerging market team put together an outstanding quarter under the circumstances, posting a 9% organic gain. This progress derived from a combination of innovation and new product launches as part of our mid-price point, or MPP, initiative, coupled with aggressive price recovery actions taken early in the year to combat currency declines where appropriate.

Latin American served up a stellar performance in the quarter, achieving mid-teens growth on the back of extensive commercial excellence initiatives in Mexico, Peru and Argentina, which more than offset ongoing market headwinds in Brazil. High single-digit growth in Asia, combined with the LatAm performance, more than offset countries-specific pressures in the Middle East and Africa.

All in all, the Tools & Storage business started the year vigorously and remains fixated on maintaining its strong growth momentum. The team is leveraging SFS 2.0 initiatives to continue driving tactical share gains and affecting a digital transformation across the enterprise. And at the same time, they are preparing for a major new power tool product rollout in the second half, as the breakthrough innovation pillar of SFS 2.0 will soon come to life and begin to contribute to our commercial success. Stay tuned.

Now turning to Security, which continued to progress in multiple fronts in the first quarter. Security posted 1% organic growth, made significant process on profitability and improved year-over-year margins by 110 basis points. Within Europe, the business was up 3% organically for the second quarter in a row, achieving it's sixth quarter -- sixth consecutive quarter in positive territory.

Higher installation revenues in multiple geographies, highlighted by gains in France, the Nordics and Central Europe were the primary growth drivers. Profitability continued to rise as volume leverage, productivity and cost actions all contributed to year-over-year margin rate increases. Solid order rates in the quarter and continued progress on the commercial front positioned us to maintain this momentum.

North American Security also made good strides. Operational improvements from field productivity gains under the Stanley Standard Field Operations initiative drove a year-over-year profitability increase. While organic revenue declined, it was attributable primarily to lower volumes in the automatic doors business which has good visibility to rebounding sales in 2Q.

The CSS business' top line was flat year over year and backlog remained in a healthy position going into 2Q. And overall, Security posted its highest operating profit rate since the first quarter of 2012, highlighting the growing success of our turnaround initiatives through improved operating performance. Although work remains to be done, which translates to opportunity, we continue to be pleased with securities trends and development.

Moving on to Industrial, results for the segment were in line with expectations as lower volumes in engineered fastening's industrial and electronics businesses, combined with a tough comp in automotive systems sales, led to an overall 3% organic sales decline for the quarter. Infrastructure was flat, as oil and gas gains, stemming from increased onshore pipeline activity, offset continued pressure within hydraulics.

Overall industrial segment profitability improved 120 basis points, as productivity and cost controls, particularly within engineered fastening, more than offset lower volumes. In this regard, the engineered fastening business performed well, notwithstanding the anticipated topline pressures. Automotive fasteners sales growth remained healthy and outpaced light vehicle production.

Productivity gains, stemming from an intense focus on cost management and supply chain efficiency through core SFS, led to the highest first quarter gross margin rate in five years. The Infrastructure business continued to deliver mixed results, with oil and gas posting double-digit organic growth, while providing good visibility to onshore pipeline projects coming online over the balance of the year and into 2017. Hydraulics, on the other hand, continued to suffer volume declines due to a persistently difficult steel scrap market.

In total, both our first quarter results for the Company and our ability to guide 2016 upward was a demonstration of the Company's underlying growth and earnings power. Robust organic growth in Tools & Storage, coupled with profitability improvements in Security and industrial, leave us well-positioned to achieve our upwardly revised 2016 outlook.

And before turning it over to Don, I want to remind everyone that we are also continuing to embed SFS 2.0 into the organization, to enable sustained above-market organic growth and margin expansion, along with high asset efficiency. We are focusing our activities in five key areas: commercial excellence, digital excellence, breakthrough innovation, functional transformation, and Core SFS.

We have clearly seen the manifestation of commercial excellence in our organic growth and margin expansion. And as I said on our January earnings call and during my earlier Tools & Storage comments, you will begin to see an exciting and growing impact from breakthrough innovation as the year progresses.

You may also see some inorganic activity in the near future as we have capital to deploy and are actively developing an acquisition pipeline, with emphasis on bolt-ons in the Tools and Industrial segments. These are truly exciting times for our Company with outsized capital efficient growth, solid inorganic growth opportunities ahead, and an ever-present focus on margin expansion, all contributing to the mix. And with that, I will now turn it over to Don Allan, who will provide the financial update.

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

Thank you, Jim. Good morning. Let's begin with a look at our free cash flow for the first quarter, which was an outflow of $158 million, an improvement of $85 million from the first quarter of 2015. The primary driver of the year-over-year improvement was a stronger working capital performance, specifically within inventory and accounts receivable.

Our working capital turns were up 0.4, finishing the quarter at 7 turns. Higher income in the current year quarter served to offset the majority of increased capital expenditures as well as some negative cash outflows in the other line. The other line items, which were primarily a reflection of timing of pension plan and miscellaneous accrual payments, as compared to the prior year.

As a reminder, the outflow of cash in the first quarter is normal seasonality, where our Tools & Storage inventory levels rise to ensure we are adequately prepared for the Q2 and Q3 demands of our key customers in the developed markets. As John mentioned earlier, and as you can see here in the takeaway, we are reiterating our free cash flow guidance at a conversion rate of approximately 100% of net income.

So let's turn to Page 10, as I would like to provide you with an updated outlook on our 2016 foreign exchange headwinds. By this point, all of you are likely very familiar with our currency trends chart, which over the last two years, has consistently depicted worsening FX headwinds on the back of perpetually strengthening US dollar. While for the first time in what seems like quite a while, we actually saw a tempering of the dollar momentum over the quarter followed by an eventual retreat against some of our key foreign currencies, most notably the Canadian dollar, Brazilian Real, and the Euro.

While on a full-year basis, we are still seeing significant currency headwinds weighing on our operating margin of approximately $140 million, this does represent a $40 million improvement from the midpoint of our initial 2016 guidance range, which was $170 million to $190 million, as we established that in late January timeframe. As a reminder, we assessed our currency headwinds on operating margin at the current spot rates.

It's worth noting that the mix of this $140 million headwind is now comprised of approximately 75% transactional exposure, which pressures our margin rate and 25% translational exposure. This is a shift from the two-thirds, one-third split we discussed in January and is driven by the $60 million of carryover currency exposures which relate to our 2015 hedging activities.

While we continue to execute mitigating actions to offset $140 million of headwinds, it is important to note that we do anticipate some pressure on planned pricing actions, particularly in countries where currencies have rebounded significantly. This will materialize as a slight headwind to organic growth, specifically in the second half of 2016.

Finally, you will notice that on the lower right-hand side of the page, we have presented our sensitivities for several of our most significant foreign currency exposures. These will be useful guides for you going forward to determine how movements in the FX markets are impacting our 2016 operating margin. So for example, a 1% increase in the Canadian dollar results in a $2 million to $3 million improvement in the 2016 operating margin on an annual basis.

Now let's turn to the next slide, which is an update on our 2016 outlook and guidance. We are raising our 2016 EPS outlook to a range of $6.20 to $6.40 from the prior range of $6 to $6.20. This revised range represents an approximately 5% to 8% increase over 2015.

We are also reiterating our free cash flow, as I previously mentioned. The major changes behind the guidance increase are as follows. As you can see, we are now expecting organic growth of 3% to 4% versus the original estimate of approximately 3%.

The primary drivers of the change are an increase in our Tools & Storage growth assumption to mid-single digits on the back of a solid first quarter performance, strong POS data, and signs of continued strength in resi and non-resi construction markets. However, this strength is partially offset by revisions to Industrial's organic growth outlook, which we now see as relatively flat versus an assumption of up slightly in our initial guidance.

This revision is due primarily to lower than anticipated volumes in engineered fastening electronics business, as volume expectations for the largest customer in that business continue to decline. Additionally, we expect the timing shift around certain oil and gas pipeline projects from the second half of 2016 as they move into the first half of 2017.

Finally, as I mentioned earlier, there's also some pricing pressure relative to our initial estimates coming from certain foreign markets that have recently seen significant strengthening in their currencies versus the US dollar. Accordingly, we expect all of these puts and takes around our organic growth assumptions to result still in a net increase to our EPS of approximately $0.05. The next item, which we discussed in length on the previous slide, is the approximately $40 million improvement in foreign exchange headwinds, which we expect to translate to an increase of EPS of approximately $0.20 for the full year.

And then finally, slightly higher than planned marketing costs related to the Tools & Storage product launch, that Jim alluded to and discussed briefly a few minutes ago, are expected to result in approximately $0.05 reduction to EPS. The majority of these costs will occur in the second half of 2016. These three assumption changes result in a net increase of $0.20.

Turning to the segment outlook, the Tools & Storage and Industrial segments' organic growth outlook change along the lines I just previously discussed, and Securities organic growth outlook remains low single-digits. In terms of profitability, Tools & Storage is the only change from our January guidance, moving to modestly positive year over year from relatively flat, and the driver of that is the reduction in the FX headwinds, primarily.

We continue to expect Securities margins to be modestly positive year over year, as operational and field efficiency improvements continue to progress and then the Industrials margin to be relatively flat, with productivity gains and cost take-outs being able to offset the topline pressures we continue to see.

The last point I'd like to make is related our EPS guidance expectations for the first half of 2016. As you can see, we expect the first half 2016 operating profits, as a percentage of the full year, to be slightly above the prior-year period. However, lower plan restructuring as well as lower other net expenses and shares will result in first half EPS being higher as a percentage of the full year than it was in the prior year, specifically, first half 2016 EPS, as a percentage of the full year, will approximate 48% versus 44% in 2015.

So let's move to the summary page. The first quarter was a strong start to that year, with organic growth, up 5%, and EPS, up 20%. As a result of this strong performance combined with the improved outlook in the Tools & Storage business and currency markets, we are raising 2016 guidance for full-year to a range of $6.20 to $6.40, which represents a 5% to 8% increase in the earnings per share versus 2015.

As we continue to progress through 2016, our focus remains on the following: driving organic growth across all businesses and sharing continuous improvement in our operational excellence initiatives, maintaining the momentum behind Securities margin improvements, and as always, pushing ourselves to manage our working capital in the most efficient and effective manner possible.

That concludes the presentation portion of our call and now let's move to Q&A.

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

Great. Thanks, Don. Kaylee, we can now open the call to Q&A, please. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jeremie Capron with CLSA. Your line is open.

Jeremie Capron - *CLSA - Analyst*

Thank you and good morning, gentlemen. Clearly, there's a lot of excitement around new product introductions. I think Jim, you talked about breakthrough innovation and we should stay tuned for that hitting in the second half. Can you maybe give us a little more color around that in terms of the scale of those new product launches and maybe come back to what happened in Q1, because I think you called out new products as a major reason for the strong performance in Tools & Storage as well. Thanks.

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

Sure. This is Jim. The breakthrough innovation initiative is something that we started, really, started getting into in the early part of 2014 and the concept behind it is that we do a pretty good job in what we call, core innovation, and we did this in both legacy Black & Decker and legacy Stanley.

And those are the kinds of things that are driving the organic -- big driver behind the organic growth today in some of the new product introductions I alluded to in the core innovation area, but those are more things like in the Hand Tools business, for instance, we introduced a line of FatMax Hammers and Prybars and Knives & Blades innovative line in one of our large retailers.

In another large retailer, we introduced DeWalt Prybars and Pocketknives and then in professional power tools, contact Generation 2 (inaudible) DC Brushless, some really interesting innovation is in the DeWalt Pneumatics lines, a MAC Impact Wrench, but you get the idea here. This is sort of the day-to-day innovation that just goes on as a matter of course, but I would say the level of activity in this area and the freshness of the Company's product lines has never been greater, in our recollection.

So that goes on and that drives the kind of growth, the organic growth along with the commercial excellence initiatives that you have been witnessing now here, along with a little help from the US DIY and construction markets. But you can see the growth all over the world, so in Europe, which is relatively anemic in terms of its markets, we still are growing an average of about 6% to 7% over two, 2.5-year period.

So there's something going on there and it's really a combination of the core innovation and the commercial excellence. So what is the breakthrough innovation? The breakthrough innovation is the concept where we actually took people out of the mainstream of the core innovation and set them aside, a small group of people, 10 or 15 people in that range. And we just said, come up with a next major breakthrough innovation for power tools.

And we gave them a timeframe and we gave them resources and support and lo and behold, in a relatively short period of time, they came up with something very, very interesting. What is that? You will have to wait and see what that is but from a scale point of view, we say for the breakthrough innovation and this is not the only breakthrough innovation team in the Company by the way. This was just the first one.

We have three more in oil and gas. We have one in hydraulics. We have standing one up in engineered fastening but we tell them that whatever you come up with, it has to have a scale of at least $100 million of revenue to be interesting to us and so I can't really get into how this big one could be because we, frankly, we don't know.

But we know it's going to be at least $100 million over time and it could be far, far greater. So that is kind of the background and what you have going on now is the commercialization of that. It will begin shortly and you will see it in stores in relatively short order.

Operator

Our next question comes from the line of Ken Zener with KeyBanc. Your line is open.

Ken Zener - *KeyBanc Capital Markets - Analyst*

Good morning, gentlemen. Given the strength that you have in Hand Tools picking up, could you -- and the very strong organic growth that you are seeing in the US, could you kind of talk about how the landscape, because since it looks like you're going to be well over $6.00 this year. Currency is helping, but I mean that was a long-term goal when you did the Black & Decker acquisition.

Can you talk about how much that landscape has changed on the power tools relative to -- I don't want to say it's third-party competitors, but your high margins that you have are obviously a very different business versus five years ago. It seems like you're just gobbling up market shares certainly on a dollar basis, if not unit basis. Could you just talk about how that's really structurally changed again, given how strong you were this quarter?

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

Yes. It's Jim, again. I think the -- what's really going on here is that the Black & Decker and Stanley integration, the merger of the two companies and the successful integration was a major home run, I think, well beyond anybody's wildest expectations.

I think the cost synergies were just the beginning. We -- I think we signed up for $350 million, six years ago and we've cut the -- cut off the analysis at about $550 million of cost synergies and that was a huge outperformance but the thing that we never really expected was the revenue synergies that we -- also beat what we expected to accomplish but they just keep on coming.

And it has to do with the fact that the cultures gelled so well and got so focused on innovation, commercial excellence, all the kinds of things that I was just talking about and really put all of the BS from the typical integration politics, et cetera, behind them, and focused on the customer, focused on the markets.

And then the scale that we achieved by putting the two companies together and going to market with power tools and hand tools and going to market with all of these incredibly strong brands that we have just gave us tremendous flexibility and we just continued to benefit from that as time goes on.

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

And I would say, a current example of those revenue synergies that we touch on here and there is what we've been doing in emerging markets, where we've been rolling out the mid-price point products, in particular, power tools that have the Stanley brand on it. And so that's a great example of continued generation of revenue synergies six years after the merger.

Operator

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

Michael Rehaut - *JPMorgan - Analyst*

Thanks. Good morning, everyone. Nice quarter. You specifically -- just had a question on the security margins, as you highlighted a very good first quarter result, best since 2012. Just was curious if you could help out with kind of getting a little more granular in terms of the margin improvement there off of the revenues down 1%?

And perhaps just getting -- giving us a sense of the perhaps bigger components of that, also North America versus Europe, and how you see that playing out over the next year or two? And perhaps also you can kind of revisit on a more broad basis, just the future of the segment overall, as you called it out in your Analyst Day as being the strategic direction being under review given the solid progress here. How does that affect that? So, sorry, a couple questions but all around, the Security, the progress.

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

Okay. Mike, this is John. I will start. I think there was more than one question there, but we will try to do the best we can. Let me comment on two things, and then Don will give you a little bit more granularity. As it relates to our assessment of the segment, nothing's changed. We love this business and the fact that it continues to grow and margins continue to improve, we've said on many occasions, our single greatest self-help opportunity in terms of margin improvement and earnings growth is restoring Security back to its historical levels.

We continue that trend and that is why Jim expressed the gratification or encouragement that that trend has continued for six consecutive quarters. As you know, Europe, margins in Europe, in general, are lower in the US but the overwhelming majority of the improvement is coming from Europe, albeit from a low base. So I doubt -- we will not forecast margins by subsegments because, A, it's very difficult and B, there's not much in it for us if we get it right and a lot of explaining to do if we don't.

But in terms of the assessment of the category itself, we love the business. We review status with our Board, every Board meeting. That concluded yesterday and the day before. A year-and-a-half ago, we said in the second half, sometime during the second half of 2016, we would be very public in terms of what our plans were. We're sticking to that and we're not going to accelerate it. Beyond that, Don, if you want to add a little granularity, please feel free to do so.

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

Sure. So when you look at the first quarter performance, Jim mentioned that we were very pleased with the profitability of the segment. And really, the improvement that we saw was in all three regions of the world, so the big regions are North America and Europe.

Our emerging markets is relatively small and in those two large regions, we saw a really solid improvement year over year in the profitability as we continue to execute on the initiatives that we have been, really, discussing almost for two years now of improving field productivity and the electronic security business, in particular, in both Europe and in North America.

And then in Europe, specifically looking at our SG&A, our selling and general and administrative costs, to making sure they are in line with the revenue of the business as well as the percentage of revenue. We discussed it as a business that probably should be somewhere below 30% of revenue for SG&A and it's above 30% today so we continue to take actions in those areas to improve the profitability of both businesses.

And we're seeing the benefits of that over the last two or three quarters, in particular, as the profitability of the business year over year continues to improve. And at this point, based on our guidance for the year, we are expecting that trend to continue as we expect modest improvement in profitability of the segment for the full year.

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

Mike, and just one other point on the business in general. Jim has talked about it on past calls, but it just shouldn't go unnoticed. There's been a lot of organizational changes where we think and we've been talking about it for awhile. But the majority of them have now been in place for about a year where we think, to use Jim Collins often used term, we think not only we have the right people on the bus, we have them in the right seats on the bus.

And it really matters. Everyone knows that but the fact that we've had a stable, capable, tested and proven team in Europe and in the US, supplemented by a couple great new hires in the last six months or so, it's really, really helped out, first of all, stabilize that business and then ultimately, keep the -- keep both organic growth and margins moving in the direction we want it to.

Operator

Our next question comes from the line of Jeff Sprague with Vertical Research Partners. Your line is open.

Brett Linzey - *Vertical Research Partners - Analyst*

Hi, good morning. This is Brett Linzey on for Jeff. Just wanted to come back to free cash flow. You guys had strong working capital quarter and I suspect some of that was inventory drawdown on the industrial side to -- into a line with weaker demand there.

But could you just talk about where you guys feel you are relative to that 100% conversion for the year? I mean, seemingly, there's a path higher. Is that the case and is there anything in terms of inventory ahead of this product launch that we should be thinking about?

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

Sure. This is Don and I will take that. I -- as I mentioned, we are very pleased with the start to the year related to working capital. Part of it was due to the fact that we did have a very strong March, month of March, and so our inventory levels were brought down in line with that performance which was great to see.

And we also were very focused on making sure that we collected the cash throughout the quarter, so our accounts receivable was down at the right level as well. So with our Company, we're going to have a cash outflow, as I mentioned in the first quarter every year because of the way the Tools & Storage business seasonality impacts the Company.

But you have to, you really have to try to minimize that to achieve your objectives for the full year and I think we've done this. This is the best performance we've had in Q1 in four years related to Stanley Black & Decker and so as a result, I feel very good about our ability to achieve 100% conversion rate because we started the year in that regard.

Now your question to potentially additional inventory related to the product launch. Yes, we will have some additional inventory; however, based on the current sales plans as the year progresses, we would expect those inventory levels, a vast majority of them to be absorbed and shipped out to many of our major customers.

And so we don't expect that to be a challenge for us as the year ends. But it could be a little bit of additional inventory as we go through the second and the third quarter which we would normally see anyways in our Tools & Storage business. So at this stage, we feel good about our ability to hit our objective 100%. And we will continue to look at that to see how we can potentially outperform that as the year goes on.

Operator

Our next question comes from the line of Rich Kwas with Wells Fargo Securities. Your line is open.

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

Hi. Good morning, everyone. I'm going to sneak in a couple questions here. John and Jim, just wanted your thoughts on the mechanical business in North America, so from a growth standpoint, that continues to underperform key competitors out there and curious, John, your reference to how you got the people in the right spots. Wanted to get your level of confidence around getting the growth rate up and going there considering the cycles, turning in favor in terms of non-res.

And then quick second question, Don, in terms of the hedging strategies, I know you -- thanks for the sensitivity on the various currencies but last year, you went -- you got opportunistic when you had a lot of volatility. And I'm just curious. Would you -- if we got volatility over the next few months on currencies, would you take the same approach and just curious on around risk as it relates to the updated guidance with currency and your comfort level with that? Thank you.

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

Yes, Rich, I'll take the mechanical piece. I guess, in -- excuse me, in three bites. Margins are good. Growth is below what we would expect it to be, to a large extent, historically, that has been a product issue where we've been -- we have been behind our own expectations in some of the market.

That being said, our sense is it's going to be offset by two things. One is the leadership in that business, we believe is quite capable. We have a tested and proven individual who actually came from the DeWalt professional industrial channel. Very, very good person to lead, guide the business and focus on growth as opposed to just margins and things of that nature.

So we feel good about it from that perspective and last, but absolutely not least, recall we just really completed an embedded change to third-party or independent distribution model versus a direct model. And Jim has talked about this often in past calls. Years ago, we thought that was a distinct competitive advantage and it was for a time.

We made the decision and I think it was the right one that what we gained -- we lost more than we gained as a result of that. It was two-year process to, if you will, simply convert our distribution model. That is behind us; it's beginning to gain traction.

So right leader in place, growth-focused executive, and the right distribution model in place. Product catching up gives us cautious optimism that we will get that growth back in mechanical because it's a great opportunity for us.

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

Yes, and let me just supplement that by saying, so as John described the operational condition of the business is good and getting better and we are pleased with that. The question that we still have to answer is the one -- is the strategic question and that we'll put on hold until we come out in the second half of the year with our Securities portfolio review. So that's -- everything is fair game in Security including mechanical.

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

And I'll touch on your question related to currencies. Clearly, we always look at opportunities for hedging when we see shifts in currency and we will continue to do that we've done that again this year. Sensitivities give you an indication of if currencies move in certain directions for the remainder of the year, what the impact could be to our operating margin and we have thought through it.

I mean, is there potential for the $140 million to move back towards $180 million. There is a scenario where that could play out if the Fed starts talking about potential interest rate increases that could actually result in strengthening of the US dollar and a weakening of some of these currencies. However, we also feel like we've built contingency plans to address that scenario if that plays out.

So we have certain actions that we would take, up to $180 million, that we believe would be capable of offsetting that which is why we felt comfortable making this increase to our guidance.

Operator

Our next question comes from the line of Tim Wojs with Robert W Baird. Your line is open.

Tim Wojs - *Robert W. Baird & Company, Inc. - Analyst*

Hi, guys. Nice job. Just on the Tools business, if we could go back to that for a second. So the full-year guidance is up mid-single digits, but you've got 8% in the first quarter and then as you go through the year, the comps get a little bit easier in the second half and you have some new product rollouts. So can we -- can you just talk about some of the puts and takes and why maybe we should see decelerating growth in the Tools business this year.

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

Well, I think you might want to think about the first quarter performance and just -- we mentioned some things about -- certainly, the weather was an additional boost to us in Q1 and in particular, in North America, as we actually had a mild winter here for the first time in, well, a long time for those of us in the Northeast.

And we benefited 1 point or 2 points in our Tools & Storage business from that. So if you kind of regulate the growth, saying, that's not going to necessarily repeat itself for the next three quarters, then you're down to something that is closer to 6% to 6.5% roughly.

And then we had a fantastic performance in emerging markets in the first quarter, up 9%; we haven't seen that type of performance in almost 2.5 years. And so we were pleased with that. Feel very good about it, but at this stage, we're not necessarily ready to say that's something that's going to repeat itself in the next three quarters.

We're clearly focused on trying to maximize that opportunity but to be able to project that and say, for sure, that's going to happen at this stage would probably be a little bit overly optimistic and those two factors in itself kind of get you down to a mid-single digit number for the full year for organic growth.

Operator

Our next question comes from the line of David MacGregor with Longbow Research. Your line is open.

David MacGregor - *Longbow Research - Analyst*

Yes. So congrats on a good quarter and all the progress. There's a lot of data out there right now, including Bureau of Labor Statistics data, just showing a clear shift in the United States of labor from energy and mining into construction. I'm just wondering if you feel this is having a meaningful impact on tool growth and just talk about the extent to which you see that as a factor going forward.

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

I will take it, David. The interest, yes. To quantify it would be very difficult because it is happening and one of the constraints that we would listen to some of the homebuilders' calls, as a good example, was basically securing enough qualified capable labor because so much of it during the financial crisis shifted from construction into energy. As some of that variable labor pool, if I can call it that shifts back, the answer is absolutely yes.

If the demand is there but the qualified, capable, technically-trained or appropriately-trained workers aren't, it's going to be a governor on growth. So simply said, yes it's having an impact. I think it's the early stages of that but that's clearly helping the North American residential and we think, ultimately, commercial construction market.

Operator

Our next question comes from the line of Jeff Kessler with Imperial Company. Your line is open.

Jeff Kessler - *Imperial Capital - Analyst*

Thank you. You've been talking -- after the implementation of SFS, you've been talking -- you mentioned it twice in the first -- in your presentation. I'm wondering and you mentioned that the implication and the actual evidence of that is going to be shown somewhere this year, perhaps sometime in the second half. Could you be a little bit more specific as to how we're going to see SFS be -- come out in the -- not so much in the numbers but how it's going to come out in the operations that you're showing, which in turn, affect the numbers?

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

Sure. Well, I talks about the five elements of SFS. We will start with the Core SFS, which is the, basically, the continuation of the SFS that we started in 2006 that got us to 9.2 working capital turns last year and got us customer-facing metrics that were very, very strong in relation to competition and make most of our customers very happy.

So that Core SFS is at the heart of all this and that is much more of an operations-related initiative and it continues to become deeply rooted 10 years into its existence. And now what we're doing with our Core SFS is we are taking it to another level and largely to digitizing the supply chain and -- as well as implementing the smart factory across the Company.

That's kind of in the earlier -- early stages but nonetheless, it is underway and that -- so if we are at 9 turns at the end of the year and we typically generate about 4% -- 3% to 4% productivity, worldwide cost productivity a year, in our factories.

And we would expect that to continue on the basis of these investments that we're making in some of the things that I'm talking about as well as gradually push that working capital turns number up towards 10 and maybe even, someday, north of 10. So that's the Core SFS.

Then there are three elements that are far more growth-oriented and those are the digital excellence, commercial excellence and breakthrough innovation. We talked about breakthrough innovation, I think, at length and I think that's pretty clear.

The commercial excellence is really taking some of the continuous improvement concepts that are very familiar to people in business and applying them to the customer-facing processes that drive growth. And so becoming world-class in some of these elements, like sales force effectiveness, like promotion planning, like pricing, pricing excellence and so on.

And there's a number of these areas that when we apply continuous improvement principles to them in multiple facets, they just have an ability to generate tactical share gains and also margin expansion. So that's the commercial excellence.

And then the digital excellence is one we will also see some really interesting things in the marketplace this year in the second half. There probably won't be dramatic revenue drivers but will clearly be ways to enhance the marketing prowess and depth of penetration in our Company and also, just contemporize our value propositions.

So that we are, again, leading the marketplace with technology on the digital front as well as taking digital and permeating it into the organization for purposes of efficiency and effectiveness. So that's kind of the -- those are the various elements.

The one I didn't mention is functional transformation and that's a very extensive initiative led by our finance and IT leaders who are actually taking a clean sheet of paper, after having done 100 --almost 100 acquisitions in 12 years, taking a clean sheet of paper and redesigning our processes in finance, IT, HR, legal, et cetera, to make sure that they are as efficient as possible.

We already believe that they are quite effective but we also believe there is a couple points of G&A that could come out due to increased efficiency when you start with a clean sheet of paper. That's a long-term initiative. We're not going to see a lot of overnight successes there but it's one where we're making some investments and then over the course of a couple years, we're really going to start to see that SG&A percent come down as a percent of sales and we're going to take some of the money that comes out of that and reinvest it in some of the growth initiatives.

Operator

Our next question comes from the line of Mike Dahl with Credit Suisse. Your line is open.

Mike Dahl - *Credit Suisse - Analyst*

Hi. Thanks for taking my question. First, a question around some of the M&A opportunities that you mentioned at the -- in the initial commentary, looking at the bolt-ons in Tools and Industrial. Just curious, with all of the market volatility in recent months, what's your take on how seller expectations have shifted, if at all? What types of sellers are you hearing from and again, if that has changed over the past six months or so and then just remind us again of kind of what specific areas you think you are looking to fill some gaps in within Tools? Thanks.

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

Sure. I -- this is John. I'll start -- we're not going to obviously talk specific targets, never have, never will and I know you understand and respect that. That being said, I think we've been very transparent in terms of where we're going to grow, where we're going to acquire. We're going to continue to consolidate the Global Tools & Storage industry and we really, really like our position and our opportunity to grow our Engineered Fastening business.

Having said that, I think importantly, our pipeline is quite full and the reason being, as you know, we've been on somewhat of a moratorium for the -- self-imposed for the last 18-plus months. But it doesn't mean we stop looking at, assessing, in many cases, keeping targets warm. So there's plenty out there in our previously identified areas of strategic focus.

In terms of expectations, not a lot has changed. Remember much of these -- many of these are not public companies, number one. But there are always multiple expectations but in terms of what is out there and competition for targets, double-edged sword, not too much has changed. Interest rates are obviously very, very low, which would help financial sponsors as they seek to acquire, offset by the fact that most financial sponsors and most of the targets that we are looking at have limited, if any, synergies.

So our opportunity to acquire in spaces where we have a great footprint already to arguably -- the synergies that we can generate would more than offset, I'll say, lack of leverage given our desire, insistence on maintaining strong tier upper investment grade credit rating.

Operator

Our next question comes from the line of Robert Barry with Susquehanna. Your line is open.

Robert Barry - *Susquehanna Financial Group / SIG - Analyst*

Hi guys, good morning. Wanted to actually touch on or follow-up on the strength in emerging market tools. I think in your comments, you referenced some pricing actions related to recouping currency. I was curious, were those materially higher in 1Q and do you expect them to benefit future periods as well? And if you could also just s remind us what the emerging market margins are tracking at in Tools versus in the developed markets? Thanks.

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

This is Don. I will take the -- your questions. Yes, the -- we certainly had a benefit from price in the first quarter, as we communicated early this year back in January. And then we have over the last couple years, as we see these types of movements, we take appropriate price actions where we can to offset that impact, at least, partially or in some cases, close to 100%. And we did do that in the first quarter.

And a significant portion of that organic growth we saw was related to price which was also why we're not necessarily thinking this is a business that's going to grow 9% for the full year because we are going to see some pricing pressure that I touched on in some of those key markets because of the weakening of the US dollar versus some of those key currencies that just occurred over the last six to eight weeks. So because of that, our view is, I think, prudent and it is more reflective of a different pricing market because of the currency shift.

And then you ask about profitability margins in emerging markets for Tools. That is slightly below line average at this point for our Tools & Storage business but it's an area, as we continue to ramp up some of the mid-price point initiatives, and we continue to grow with the markets and outpace them, most likely 1.5 to 2.5 times GDP growth that we expect with a leverage opportunity that it will get very close to line average.

Operator

Our next question comes from the line of Liam Burke with Wunderlich. Your line is open.

Liam Burke - *Wunderlich Securities, Inc. - Analyst*

Yes, thank you. Good morning. John, on the online strategy you have, especially in North America, are any brands doing particularly better or more geared towards online rather than your traditional distribution channels?

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

I think you almost answered the question as you asked it. Brands do well online, with -- and with the two different groups or via e-Commerce. The Black & Decker brand for DIY users is extremely popular, both DIY power tools, outdoor products, et cetera, but a real driver is DeWalt.

It's the brand the pros go to. It's available online and we are very thoughtful in terms of the extent to which we promote it, make it available, push it, because prior to the Stanley Black & Decker merger, DeWalt actually, other than via retailers' own online opportunity, DeWalt wasn't offered online.

It is now. It's doing well. But think of our three power brands, Stanley, DeWalt, Black & Decker, their specific end user groups and to each and every one, they are all doing encouragingly well. The biggest single dollar percent though would be DeWalt.

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

And it's Jim and I would also just add that very interestingly, a couple years ago, we did a complete refresh of the Black & Decker brand and it had really gotten a little bit stale and it had left of bit of its identity. And when we did the refresh, we tried to bring a millennial sort-of focused element to it. And we added some lifestyle elements related to the millennial population as well as the eco-smart aspect which is the sustainability of some of the products and packaging and so on.

And the Black & Decker brand has really made a lot of progress with the millennial population. It is definitely not the -- your father's Oldsmobile. It's going from sort of the mature demographic to the up-and-coming, so even though it's not the dollar leader in terms of what we saw in e-Commerce, it is, for the medium to long-term, has tremendous potential as the generational shift continues.

Operator

Our last question comes from the line of Dennis McGill with Zelman. Your line is open.

Dennis McGill - *Zelman & Associates - Analyst*

Hi, good morning. Thank you. Just want to dig in a little bit, Don, on the Security outlook where you're looking for any organic growth beside the low single digit. The 3% to 4% in Europe seems to be pretty sustainable and consistent with what you guys have done. I assume that's baked into the outlook so from the North American side, how do you think about the potential through the year going from the modest declines so far as you progress through the year and the end channel opportunity in general?

Are you optimistic that the non-res market is accelerating is it more just self driven to close the gap with the non-res market is accelerating? Is it more just self-driven to close the gap with the non-res market? Just curious on how you're thinking about that.

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

Sure. I think as the year progresses and you're right about Europe. I would imagine that it will continue on in this 3% trajectory that we've been seeing for the rest of the year. I think North America, what we will see positive performance in our mechanical businesses in the low single digits and then, our convergent business continues to be focused on a lot of different activities.

And as a result, I do think they're behind the market pace a little bit but as the year goes on, that will continue to improve but we will probably see a little bit of pressure in the organic growth throughout the year. And then the last thing I'd mention is we will continue to see emerging market pressure within Securities for organic growth. We definitely experienced that in Q1, although it's a small part of the total business, I do think that will be a little bit of a pressure point as well.

Operator

Thank you. And I would now like to turn the call back to Mr. Waybright for closing remarks.

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

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

Operator

Ladies and gentlemen, thank you for participating on today's conference. This does conclude the program and you may all disconnect. Everyone have a wonderful day.
