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SWK - Q3 2016 Stanley Black & Decker Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 diluted EPS of $1.68. Expects 2016 EPS to be $6.40-6.50.

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CORPORATE PARTICIPANTS

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

Jim Loree *Stanley Black & Decker Inc. - President and CEO*

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

CONFERENCE CALL PARTICIPANTS

Rich Kwas *Wells Fargo Securities LLC - Analyst*

Jeffrey Sprague *Vertical Research Partners - Analyst*

Nigel Coe *Morgan Stanley - Analyst*

Jeremie Capron *CLSA - Analyst*

Shannon O'Callaghan *UBS - Analyst*

Michael Rehaut *JPMorgan - Analyst*

Mike Wood *Macquarie Research - Analyst*

Robert Barry *Susquehanna Financial Group - Analyst*

Liam Burke *Wunderlich Securities Inc. - Analyst*

Saliq Khan *Imperial Capital - Analyst*

David MacGregor *Longbow Research - Analyst*

Dennis McGill *Zelman & Associates - Analyst*

Josh Chan *Robert W. Baird & Company - Analyst*

PRESENTATION

Operator

Welcome to the Q3 2016 Stanley Black & Decker Inc. earnings conference call. My name is Nicole and I will be your operator for today. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session. Please note that this conference is being recorded.

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

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

Thank you, Nicole. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's third-quarter 2016 conference call. On the call in addition to myself is Jim Loree, our President and CEO, 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, Jim and Don will review our third-quarter 2016 results and various other matters followed by a Q&A session. And consistent with prior calls, we are going to be sticking with just one question per caller.

As we normally do, we will be making some forward-looking statements during the call. Such statements are based on assumptions of future events that may not prove to be accurate and as such they involve risk and uncertainty. It is therefore possible that actual results may materially differ from any forward-looking statements that we may 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.

I will now turn the call over to our President and CEO, Jim Loree. Jim?

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

Thank you, Greg. Good morning, everyone, and thanks for joining the call.

In the third quarter we continued to perform at a high level delivering modestly above market organic growth. We also achieved another quarter of margin expansion despite a challenging external backdrop which included slow global growth, dollar strength and geopolitical and other volatility. In a few minutes Don will provide color on each business segment. But first here are a few highlights.

Total Company organic growth was 3% in the quarter and revenues were up 2% net of currency. Tools and Storage led the way, up 5% with the European team contributing a remarkable second consecutive quarter of double-digit growth up 11%. The Security segment continued to make good progress, up 2% organically with all regions contributing. The North American business delivered 1 point of organic growth to go along with noteworthy year-to-date margin improvement. Industrial was weighed down by the impact of one major electronics customer and to a lesser extent by general industrial market conditions. As a result, the segment continued to experience topline contraction, in this case 4%.

On a very positive note, total Company operating margin expanded 40 basis points year-over-year to 15.2% as a strong operating performance more than offset the impact of currency headwinds and the cost impact of growth investments.

Diluted EPS was $1.68, up 8% year-over-year on continued revenue growth with solid operating leverage driven by disciplined price management and cost control, productivity gains and commodity deflation among other factors. The third-quarter also marked the beginning of the exciting launch of the DeWalt FLEXVOLT system, the first breakthrough innovation coming out of SFS 2.0. This introduction has been met with unbridled enthusiasm across our professional customer base. The magnitude of the technological accomplishment in conjunction with the sheer breadth and depth of the marketing campaign has driven strong early momentum. We expect the success of this initiative to continue into the fourth quarter through 2017 and for years to come.

In fact, the early returns suggest that this will be the largest and most successful power tool product rollout in our Company's history. This success will likely enable us to continue our strong Tools and Storage organic growth track record into 2017 despite having to overcome comps from 2014, 2015 and 2016 averaging 7% annually.

Finally, I am pleased to note that we have raised the midpoint of our full-year 2016 EPS guidance by $0.05 from $6.40 to $6.45 and tightened the full-year EPS range to $6.40 to $6.50. It was previously $6.30 to $6.50. Don will cover this increase in the midpoint in more detail during his remarks.

Moving over to M&A, as many of you know on October 12, we announced the signing of a definitive agreement to purchase the Newell Tools business including the Irwin and Lenox brands from Newell Brands Incorporated. I would like to spend a few minutes sharing some thoughts on this transaction.

I will start by saying that we are very excited by the growth and margin expansion opportunities this deal brings. In addition to clearly identifying achievable cost synergies, there is tremendous strategic value here. We see significant opportunities for revenue synergies in both the short-term and the long-term. Opportunities include channel optimization, cross-branding of product lines and geographic expansion. These opportunities are very similar on a somewhat smaller scale to the ones we were so successful in pursuing with regard to Black & Decker, a gift which keeps on giving.

We are fortunate to have the same tools senior leadership team in place that integrated Black & Decker and that team is now focused on the Newell business. We also really like the assets. The Lenox and Irwin brands are among the best in their respective categories and are attractive and powerful additions to our portfolio. The product offerings are highly complementary to our existing tools product line and significantly increase the size of our hand tools and power tools accessories businesses.

Newell Tools also extends our channel presence in the plumbing and electrical trades which are both attractive adjacencies to our legacy core markets.

You can see a breakdown of revenues by region and product mix as well as by brand on the right-hand side of the page. This transaction brings top-tier positions globally in both the band saw blade and linear edge markets where the Lenox brand reigns supreme while also meaningfully bolstering our pliers and accessories product lines among others.

As we noted on the deal announcement call, this transaction marks the end of our nearly three-year self-imposed M&A moratorium and over that time we significantly strengthened the foundation of our core businesses, implemented a new enhanced operating system SFS 2.0, drove gains in organic growth and margin expansion while advancing our incremental and breakthrough innovation processes, all of which position the Company for strong performance over the last few years and into the future.

I am pleased that our first acquisition after this break is a business that lines up so well with our strategic growth framework and our core competencies. In line with that framework and our financial criteria we expect EPS to be accretive year one delivering $0.15 a share and growing to at least $0.50 a share in year three, both on an ex-charges basis. The transition and integration planning is now underway with closing expected sometime in 2017 most likely in the first half.

At this point, I will turn it over to Don Allan who will cover detail on segment performance as well as provide a financial update. Don?

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

Thank you, Jim. Good morning, everyone. We will now take a more in-depth look at our third-quarter performance across the segments.

As previously mentioned by Jim, the Tools and Storage business delivered another outstanding quarter of organic growth, up 5%. As we saw continued significant share gains in Europe which was up 11% and had solid performance in North America which grew at 4%. The emerging markets were up modestly in the quarter as declines in the Middle East and Northern Africa offset mid to high single-digit growth in Latin America and Asia. Over the last few quarters we have been adding commercial and leadership resources to the Middle East and North Africa team and expect that business to swing back to a positive organic growth trajectory in the coming year.

In North America, share gains were driven by US retail, up high single digits despite inventory reductions by certain retail partners and we had a very strong performance in Canada also up high single digits. In the aggregate, this strong performance more than offset persistent weakness in the North American industrial tool channel. Within our US retail channels, POS remained healthy and excitement around the FLEXVOLT launch met lofty expectations leaving this product line on track to deliver on our 2016 revenue expectations.

We have talked quite a bit over the last few quarters about how an incredible technological accomplishment the tools team has been able to deliver with this new product platform, developing FLEXVOLT from scratch through our breakthrough innovation process and driving it from concept to store shelves in just under two years.

But I also want to highlight how proud we are of the commercial teams efforts in coordinating this rollout which was the first and largest global product launch in our Company's 170+ year history. The excitement and enthusiasm that they have able to generate globally while no doubt aided by the unparalleled technological accomplishment of this product, has nonetheless been simply extraordinary. This launch also serves as a perfect example of how the digital and commercial excellent pillars of SFS 2.0 combined with and enhanced the breakthrough and incremental innovation processes, compounding our engineering achievements through superior marketing, targeting and commercial efforts and paving the way for significant organic growth opportunities.

The European team continued their commercialization efforts throughout the region to drive tremendous share gains once again. When you consider the third-quarter's impressive 11% organic growth against the backdrop of a 14% gain in the second quarter and high single-digit organic growth in 2014 and 2015, the magnitude of this achievement comes into focus and is truly extraordinary.

Gains continue to be widespread throughout the region within the UK, France and Central Europe all delivering strong performances from new product development, growth investments and an ever-increasing retail footprint.

Turning to the SBUs, power tools were up 8% on the back of the FLEXVOLT launch and commercial successes that I just discussed. While the Hand Tools and Storage business declined by 3% as pressure in the industrial tool channel more than offset growth in MAC tools and strong performances in Europe, Australia and New Zealand.

From a profitability perspective, the Tools business continues to impress expanding its operating margin 70 basis points in the quarter and delivering $330 million of operating profit. These results were achieved despite continued currency pressure and while balancing growth related investments, a clear demonstration of our ability to drive operating leverage as we grow.

I will just make one final comment on the Tools and Storage business. When you think about the results the team delivered over the last few years in this challenging macroeconomic and geopolitical environment, you can understand more clearly why we are so excited about the Newell Tools acquisition. There is a significant value creation opportunity presented by folding these powerful brands and high-quality products into our best-in-class Tools and Storage operation.

Moving on to Security, the segment delivered its third consecutive quarter of organic growth, up 2% with all regions contributing. As Jim mentioned, North America posted its first quarter of growth since Q2 of 2015 led by higher volume within the commercial electronic security and automatic door businesses. It is very encouraging to see the North American team combine the field productivity and profitability improvements they have made over the last two years with budding organic growth as the business continues to progress forward.

In Europe, the team continued its organic growth trend up close to a point in the quarter making this the eighth consecutive quarter of organic growth. Higher installation volume and a strong performance in the Nordics and Germany helped to drive topline growth and offset the pressures that we have seen in the UK where we are continuing to see some negative impact on CapEx spend and commercial decisions relating to Brexit.

We also saw organic growth from Security's emerging markets operations, a positive sign for this relatively small portion of the segment. Margins in the Security segment continued to improve, up 180 basis points in the quarter. The improvement was primarily driven by the North American team's continued success with its field efficiency and productivity efforts as well as continued focus on tight controls over SG&A across the entire segment.

Margins were also favorably influenced by more intense rigor over the profitability requirements of our commercial opportunities that we implemented in the past year, the benefits of which we are now beginning to see within our operating margin rate as backlog orders are converting to revenue.

Let's move to the Industrial segment. Revenues were down in the quarter as anticipated as the impact of one large electronics customer and still weak industrial market conditions adversely impacted Engineered Fastening volume. This decline more than offset the mid single-digit growth and infrastructure resulting in an overall 4% organic decline for the segment.

Within Engineered Fastening, the organic revenue decline was largely expected. However, the global automotive business continued to perform well with solid growth in Europe and Asia which outpaced light vehicle production. This growth more than offset some slowness that we have experienced in the North American automotive business in Q3.

The impact associated with the volume declines tied to one large electronic customer had a significant impact on Engineered Fastening as well as the overall segment's organic growth for the quarter. If you exclude this impact, Engineered Fastening's organic growth would have been slightly positive and the Industrial segment's organic growth would have been 1% for the quarter.

Infrastructure posted organic growth of 5% driven by higher Oil & Gas onshore project activity which more than offset continued weakness in the hydraulic tool business. However, that is beginning to show some signs of stabilizing.

Finally, while profitability in the Industrial segment declined by 40 basis points year-over-year, the segment still managed to achieve a very healthy 17.4% OM rate as a result of significant productivity gains and cost control actions which managed to largely offset the negative margin impact from the top line decline.

So let's move to slide seven and talk about our free cash flow which came in at $169 million for the third quarter, in line with our prior year performance. The year-over-year improvement in net income of $21 million was offset by a slightly larger expansion in working capital and a higher CapEx investment of $10 million each. However and very importantly, working capital turns in the quarter improved by 0.7 turns to 7.1 times as a slight increase in working capital dollars covered a greater year-over-year revenue base.

Year-to-date free cash flow performance remains very strong coming in at $428 million through the third quarter as higher earnings combined with significantly lower expansion in working capital of approximately $200 million have absorbed $42 million of additional CapEx investments to deliver a solid $254 million outperformance versus the prior year.

The working capital discipline has been particularly impressive given the strong organic growth we have seen throughout 2016 not to mention the inventory build related to the FLEXVOLT launch which commenced in Q3.

Based on our year-to-date performance, we are reiterating our free cash flow guidance at approximately 100% conversion rate. As in the past, we expect to generate significant free cash flow in the fourth quarter on the back of solid earnings growth and the seasonal working capital liquidation we experience within our Tools and Storage business.

So let's shift to guidance on slide eight. As Jim noted at the beginning of the call, we are raising the midpoint of our EPS guidance and tightening the range from $6.40 to $6.50 from the previous range of $6.30 to $6.50. The revised range represents an 8% to 10% year-over-year increase in earnings per share. This raise is our third in as many quarters for 2016 and is representative of the continued strong performance by Tools and Storage and solid improvement in our Security segment's profitability profile. These outperformances have more than offset a difficult performance in our Industrial segment.

As you can see on the left side of the chart, the $0.05 increase in the midpoint of our guidance is driven by improved operating performance primarily within Tools and Storage. These improvements relate to continued indirect cost controls and slightly higher levels of cost productivity than originally estimated.

Please note that this guidance does exclude any potential acquisition costs which could occur in the fourth quarter related to the Newell Tools deal.

Let's shift to the segment outlook on the page. Tools and Storage is still expected to generate high single-digit growth for the full-year as we see continued share gains across the globe combined with the FLEXVOLT launch in the second half of 2016. We are still estimating the revenue impact of FLEXVOLT to be slightly under $100 million in 2016. Security is expected to grow low single digits as momentum in North America and emerging markets offsets the modest pressure we are seeing in Europe related primarily to Brexit dynamics within the UK which is impacting certain large financial customers.

Finally, we now expect a mid single-digit full-year decline in Industrial revenue as our Engineered Fastening business continues to work through the lost revenue from the previously mentioned major electronics customer which by the way will anniversary in Q4 and additionally experienced market driven headwinds within the general industrial business.

Another set of factors to be aware of in Industrial is that we expect the North American automotive business to reflect a slowing market as we end 2016 combined with a week Oil & Gas pipeline construction market in Q4.

Turning to operating margin rate, all segments remain in line with previous expectations as Tools and Storage and Security's profitability improves year-over-year and the Industrial segment decline is driven by topline contraction.

Our operating performance in 2016 has been strong with EPS growth expected to be 8% to 10% despite absorbing another year of significant currency headwinds which total $150 million or approximately $0.75 of earnings per share. We are very pleased with the team's performance to date and now are squarely focused on wrapping up a great year highlighted by a strong performance on both organic revenue and earnings growth.

In summary, the third quarter was another solid performance for the Company as organic growth finished up 3% and earnings per share up 8% versus the prior year. Tools and Storage delivered another outstanding performance. Likewise, the Security segment continues to progress driving both organic growth and margin rate expansion.

Based on this quarter's performance or outperformance that is, we are raising the midpoint of and tightening the EPS guidance range to $6.40 to $6.50 from the previous range of $6.30 to $6.50. The third quarter marked the anxiously awaited launch of the DeWalt FLEXVOLT system which was met with tremendous excitement from professionals, tradesmen and tool enthusiasts around the world. Our first of what we believe will be many successful breakthrough innovations in the future.

On October 12, we ended our nearly three-year self-imposed BD moratorium with the announcement of our agreement to acquire the Newell Tools business including the iconic Lenox and solid Irwin brands, a highly strategic and financially attractive transaction.

Lastly, we are continuing with our review of the Security business. As we have previously noted, we expect to provide an update at some point during the fourth quarter reporting period.

There are a number of exciting things happening at Stanley Black & Decker today. The opportunities presented by the FLEXVOLT launch and Newell Tools transaction are significant and robust. As we look ahead into 2017, we remain committed to delivering solid organic growth and EPS operating leverage consistent with our three-year annual financial objectives previously communicated.

That concludes the presentation portion of today's call. Now let's move to Q&A.

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

Thank you, Don. Nicole, if you could, we can now open the call to Q&A please. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Rich Kwas, Wells Fargo Securities.

Rich Kwas - *Wells Fargo Securities LLC - Analyst*

Good morning, everyone. Going to squeeze in a couple here. One for Jim, one for Don. Jim, in terms of future M&A, obviously the Newell deal announced and we are going to get some kind of resolution with Security here relatively soon. What is the appetite to do further M&A as you go deeper into 2017 and is this more of a function, a barometer around ability to execute versus opportunities out there?

Then for Don as we think about 2017 in terms of margin expansion and how you are thinking about that preliminarily, what are the puts and takes? You have had a pretty good year here in 2016 and it would seem like with commodity prices moving up a bit that there is maybe some more headwinds as we think about 2017? Thanks.

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

Okay, I will start. This is Jim. As far as M&A goes, we are historically if we go back 15 years or so and we look at the capital allocation of the Company, we have taken almost exactly 50% of our excess capital and allocated it to M&A and the other 50% we've given back to the shareholders in the form of dividends and repurchases. And during that timeframe, we more than quintupled the size of the Company and gave back a lot of cash along the way and returns to shareholders were very, very solid, 400%, 500% over that timeframe. So we like that formula.

And when we took the break, it really was an opportunity to digest many of the acquisitions that we did over that timeframe and now we are back and we intend to continue with that 50% allocation of excess capital to M&A and it is not an organizational bandwidth issue. I think Newell despite its relatively significant size is really a bolt-on acquisition for the Tool business. So I am not underestimating the importance of getting that integration right at all, it is a top priority for us but there are other businesses in the portfolio and there is also some other activity going on in the tool industry that might lead to further consolidation which we would intend to be a part of.

So we will do more deals as we go forward and it will be a contributor to our growth. We expect our organic growth to be 4% to 6% over the long-term and we expect acquisitions to contribute another 5%, 6% annually above that.

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

And I will address your second question, Rich, which is about kind of our views of 2017. Maybe what I can do is build upon my comment at the end of the presentation and give a little bit of a framework of our current thoughts related to 2017. As I presented back in our investor day in May of 2015, we gave kind of a three-year perspective, annual objectives for three years is basically what it was. And we said organic growth had a profile of 4% to 6%, organic EPS growth was the 6% to 8% so really demonstrating that operating leverage. And then obviously acquisitions, we presented something in excess of 10% EPS growth if you included acquisitions.

Our thoughts right now is that we think we are in that range. We are probably on the organic growth side at the low-end of the range which would be similar to the profile that we have experienced during 2016 around 4%. We think that is probably a good proxy at this stage for next year. And then the EPS number is probably around the midpoint of that range I just mentioned at this stage.

The other thing to keep in mind is that as you start to look at the different segments for organic growth in particular, our Tools business will probably grow about 7% this year by the time the year is done. Our Security business will be around 1% organic growth and we will see mid single-digit declines in Industrial. Keeping in mind Industrial does have that kind of difficult comp that it has been dealing with with a major customer, that if you exclude that impact it is probably down about 2% instead.

I think that is a good framework frankly for next year with maybe Tools being a little bit lower from that 7% but we will see how positive the impact of FLEXVOLT is. It is still early days, but as Jim mentioned, it is very positive at this stage. It is a little bit higher than our expectation we previously communicated that we think it will be $200 million roughly of revenue next year. And the one factor we don't know yet is the cannibalization impact.

And then the other two segments I think you will see 1% to 2% growth probably in Security and a modest decline most likely Industrial continuing as we probably work through a continued difficult industrial market. I think that is a good framework to start with and we will see how the year ends.

We haven't provided specific input around currency and commodities but at this point based on current rates, currency is probably a $20 million to $30 million pressure next year and commodities is probably a similar amount at this stage. So we don't see that as a major headwind going into 2017 which is why we still think we can achieve reasonable operating metrics.

Operator

Jeffrey Sprague, Vertical Research Partners.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Thank you very much. Just a little bit more color on FLEXVOLT if you can or if you are willing. Just wondering if you have achieved full channel fill at this point? And anything else you could tell us about promotional costs and how those could influence margins not only in the fourth quarter but maybe into the early part of next year as you continue to push forward?

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

This is Jim. The channel fill has been fairly comprehensive. It is still in process so it continues but it is on track and as Don said, we will be in the $100 million range for the four months, September through December, which meets our expectations and I would say there is probably more customer demand growing as we fill the channel and they start to see the early signs of their end-user pull. And so we are expecting a pretty good growth as we go into 2017 as Don mentioned.

As far as the margin elements, I will have Don, you can tackle that one.

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

So as we initially discussed I think back in July, the second half definitely has a little bit of margin pressure related to the launch of FLEXVOLT both on the gross margin side and then some of the activities we are doing in SG&A around the digital marketing program and commercialization activities. That is going to continue most likely into the first quarter. We don't see that as a major pressure point. As you see the business had 17.4% margins in the third quarter, very strong and up 70 basis points year-over-year. And so we don't see it as a major drag but certainly when you look at it sequentially versus Q2 as an example, it is one of the reasons why we were at 17.4% versus 18.8% in the second quarter.

But as we enter the back half of next year, margins will regulate and get to more like line averages or above depending on which FLEXVOLT product category.

Operator

Nigel Coe, Morgan Stanley.

Nigel Coe - *Morgan Stanley - Analyst*

Thanks. Good morning, gents. So, Don, great color on 2017. I am just wondering if you are factoring anything into your 2017 EPS math regarding any potential dilution from a potential Security portfolio decision?

And then just a clarification on that, that would be great. Then on the Industrial, lots of moving parts there. Oil & Gas, you have alluded that that starts to weaken in 4Q. [Hydraulics] are stabilizing and your Apple is forecasting growth in 4Q. So I'm just wondering if maybe you could give us a little bit of a roadmap on how you see the moving parts for Industrial tracking into 4Q and 2017?

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

So let me start with thoughts about 2017 as it relates to Security. We have no comments that I made, we are not factoring in any decision related to Security because obviously there's different things that are being evaluated. However, if you look at the three options we have discussed, one is obviously keeping the business which would have no impact. Second option was to do something with the entire Security business which would obviously have a significant impact to what I described. And then the third option was an evaluation of our mechanical lock business and determining potential divestiture of that.

If that was a choice that we chose, then there would be what I would say a modest dilutive impact to that. However, the proceeds of the money we receive could partially be used to do a buy back so that will minimize that dilution. So our view is we don't think -- under that scenario, we don't think it would have a large impact on the numbers that I describe. So that gives you a little bit of framework on our thoughts there.

On the Industrial breakdown, you said Apple has growth in the fourth quarter. I think you were referring to Apple the company, not our business. But we are not projecting growth in our business so that is probably part of your question. But what I said was that we are seeing slowing in the North American auto business in the third quarter. We expect that to continue as we are starting to see especially with the Big 4 a little bit lighter production schedule for the fourth quarter so we are going to probably continue to see pressure there.

The current projections for next year for light vehicle production are still positive although they are very modest, just over about 0.5% year-over-year. So North America, right now it appears to be a modest growth number for light vehicle production which we intend to outperform but we will have to watch that very closely as the year ends.

Looking at Oil & Gas, it is weakening and it is weakening primarily because there is a large project in the Dakotas of the US that has been dealing with protesters and other activities that have shut down a lot of that pipeline construction and that impacted us modestly in Q3 but we do see that as a larger impact in Q4.

So those are two factors that we are seeing in Q4 that are creating our view of guidance and why we have not raised our guidance beyond the $0.05 kind of drop through of what we outperformed or a large part of what we outperformed in Q3.

Operator

Jeremie Capron, CLSA.

Jeremie Capron - *CLSA - Analyst*

Thanks. Good morning. A question on the Security business, I see you had a small acquisition here. Can you remind us what is going on exactly? I think you referred to buying some of the franchises in the electronic security business. So any color on that is appreciated. Thanks.

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

Yes, there is an element of growth in the Security business which is supplementing our RMR portfolio or recurring monthly revenue portfolio. And so we will buy small bolt-on acquisitions typically in the $20 million to $50 million range. It is almost like CapEx. It is a bit of a steady-state but it helps supplement the recurring revenue growth because as you can imagine when you have a recurring revenue portfolio and there is attrition in the 7% to 12% range depending on the type of portfolio, that you have to originate all that just to keep the recurring revenue portfolio even. And then you have to originate more to grow the recurring revenue portfolio.

So growing the recurring revenue portfolio is assisted by supplementing it with small acquisitions but it is really not a very material amount of money to the overall corporation that we are spending on them.

Operator

Shannon O'Callaghan, UBS.

Shannon O'Callaghan - *UBS - Analyst*

Good morning, guys. Don, you talked a little bit about the FLEXVOLT being part of the sequential step down in margin this quarter but as it applies to sequentially into 4Q what accounts for maybe a further step down in margin, I mean you are launching FLEXVOLT around the holidays, it doesn't really seem like much of a holiday item. But how do I think about kind of the 4Q sequential margin dynamics relative to what we just saw in 3Q?

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

The fourth quarter normally has a sequential decline because there is a significant mix shift that does happen in Tools and Storage in Q4. Because of the holiday season you do have a higher level of Black & Decker branded products that are being sold, a little bit of promotional activities and that historically has been depending on the year, can be anywhere from 40 to 80 basis points of a drop when you look at Q3.

If you factor in the FLEXVOLT activities, that most likely will be another 30 to 50 basis points on top of that. So the other thing that we are seeing is that we are seeing a little bit of modest commodity inflation as we exit the year. It is not dramatically impacting the rate but that could be a 10th or so of a point as well our 10 basis points. That kind of gives you a little bit of granularity around that.

Operator

Michael Rehaut, JPMorgan.

Michael Rehaut - *JPMorgan - Analyst*

Thanks. Good morning and thanks for all the great detail as always. Just wanted to dial into FLEXVOLT just a touch more. I know obviously it is very early on in the launch and that launch continues in 4Q. But I think earlier you said that you kind of referenced to the $200 million sales impact for next year without commenting on cannibalization. But as you are starting to see the orders at least coalesce at this point, I was just curious if you had any updated read on what the revenue impact would be in 3Q, 4Q and if there is any upside? I think you said there was possibly some upside to the 200 next year and also any sense potentially of any cannibalization?

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

I will let Don comment on quarterly revenue splits but I don't think he will say too much. But I will talk about next year and the possibility related to FLEXVOLT. And again, we don't know about cannibalization so that is the big unknown. However, we feel like the order momentum is pretty good and the receptivity of the end-users is excellent. So we are really paying attention to how much capacity do we have if this does become a much bigger program than $200 million in 2017. And right now we are hovering in the $400 million range for total capacity and we are working to ensure that if it were even stronger than that, that we could deal with the bottlenecks. But I don't imagine we could go too much beyond that. So I think we are probably ring fencing it in a $200 million to $400 million sort of range.

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

As far as this year's third and fourth quarter, we don't really want to grind into that detail. But as we said, it is $100 million for this year, slightly under $100 million. I think you can reasonably assume that the split is pretty close to 50-50, not dramatically different than that. It is little bit more in fourth quarter, a little less in third quarter.

Operator

Mike Wood, Macquarie.

Mike Wood - *Macquarie Research - Analyst*

Congratulations continuing to drive outgrowth. Wanted to ask you on the 3% hand tool decline, just some more color there on how much is explained by the declines in Industrial Tools, what the sequential trends have been there and when you are anniversarying that weakness? And is this primarily on the CRC-Evans business I am guessing? And just more data on the MAC tools growth as well. Thank you.

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

When you look at our hand tool business for Tools and Storage, it is as I mentioned, it is pressured, it was down the 3% organically in the quarter. The pressure is coming from what we call the industrial tool business which are the brands of, Proto, FACOM, our Storage business which is under Vidmar and Lista. And then the MAC tool business is in that category. However, they are serving primarily the automotive aftermarket and they continue to demonstrate low to mid single-digit organic growth. And that has been a trend that they have been on for awhile.

So we are seeing pressure in those tools channels that has been since it started in probably the early part to the mid part of the fourth quarter last year, that pressure continues. It anniversaries obviously in the fourth quarter. We are not expecting to see growth in that profile in the fourth quarter but certainly the amount of retraction should be much smaller. Hopefully we move beyond that into next year and it doesn't become a pressure point and it is more of can it go beyond flat and how do we gain share and maybe demonstrate some modest growth in that space.

Operator

Robert Barry, Susquehanna.

Robert Barry - *Susquehanna Financial Group - Analyst*

Good morning. How should we think about the price cost spread given you are starting to plan for some inflation next year which I guess is really a question on being able to raise price here since I think you indicated earlier that you are planning for what $20 million to $30 million of commodity inflation next year?

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

So I mean this year we are going to show about 1 point of positive price. And that was in a market that was primarily a good part of the year was more of a deflation commodity situation although the amount was not really significant so we were able to get a lot of this price from two different areas. One, we certainly are getting a lot of price benefits to offset the currency pressure that you are seeing primarily in emerging markets. So if by taking those price actions, that is a big part of what that 1% is.

And then there is what I would say is the normal ongoing activity that we do in all our businesses and have been doing for quite some time which is around what I typically call surgical or strategic pricing actions which is really looking at different products, different product categories, looking at the competitive pricing dynamics, look at the value proposition and the differentiation we might have in these categories. And then really setting a pricing that we think is more appropriate for the value that we provide to the consumer or the customer.

We have been doing that, we continue to do that and that is something that I think even in a modest commodity inflation environment next year and it will be modest, remember my comments were not -- our expectations are that this is not something that is going to be a significant commodity inflation market. I just don't think the demand is there to really stimulate that type of activity. But that being said, these surgical marketing or pricing approaches are things that we will continue to do. And so although we will probably see a little bit of price pressure here and there on certain products because of what we experience with commodity this year, having a modest inflationary environment actually is helpful when you are having some of these surgical pricing decisions.

Operator

Joshua Pokrzywinski, Buckingham Research. Liam Burke, Wunderlich.

Liam Burke - *Wunderlich Securities Inc. - Analyst*

Thank you, good morning, Jim. Good morning, Don. Jim, on the Newell acquisition, would you be picking up additional distribution or is there a lot of overlap in the channel?

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

There is definitely some incremental distribution that we are picking up particularly in the plumbing and trades and electrical trades. And we really like that kind of distribution. It is very dependable kind of a favorable type of both end market and channel. So that would be kind of in the STAFDA channel and some of the other -- those types of channels outside of the home centers and mass merchants.

But then there is a lot of overlap so it is a nice balance. We pick up some incremental distribution but we also have the ability to consolidate within our existing channels and gain synergies and so on.

Operator

Saliq Khan, Imperial Capital.

Saliq Khan - *Imperial Capital - Analyst*

Good morning, guys. One quick question for you is with your increasing presence within the emerging markets, what are you hearing right now from our distributors and the channel partners both about the state of the economy over there but also what is it that you can do to improve the relations you have with them to be able to better penetrate the market?

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

I will take that one. We have excellent, excellent coverage of the emerging markets. I think the Stanley Black & Decker merger positioned us to be able to really blanket the markets with distribution coverage. And in addition to that, we have organized in a way that enables us to both get intimate local market knowledge and coverage and at the same time be able to introduce products and make marketing moves across the entire universe of the emerging markets.

An interesting walk around them, Latin America which was pretty significantly over indexed for us and has been pretty difficult over the last few years for reasons that relate mostly to political instability and also the commodity bust and the impact that had on those markets and of course the FX that came along with those problems, the currency pressures. But in any event what we see in Latin America in general is some pretty positive indications, nothing robust at this point in time. But if I were betting I would bet that the Latin American markets are going to be in general better in 2017 than they have been in recent years in the sense that Argentina with Macri and some of his reforms starting to take root and then you have the long drawn out Brazilian political drama with the scandals and so forth that have unseated the leader. And that all is going to I think ultimately result in more stability and more reforms as we go forward.

Then some of the traditional stronger, the ones that have been traditionally stronger in recent years such as Mexico will probably continue to chug along at the rates that they have been. I don't see any major dislocation there. And then as commodities have stabilized, the Western countries in Latin America like Chile and Peru seem to have stabilized as well.

So on balance, I think the Latin American situation is pretty bright for us as we go forward.

If we move over to Asia, the non-Chinese developing markets in Asia in general are stable to slightly positive. China you know is a big question mark. We don't have a tremendous amount of volume in China but the market itself is very questionable. I think right now it is hard to really believe the data that comes out related to GDP and what we see in industrial is very weak in China and we see no real reason to become bullish on industrial in China. So it is quite negative. Sooner or later I think the chickens may come home to roost in terms of the reality in China would be my guess.

Then we just take some of the other countries like Russia. That is pretty much a crap shoot in terms of what is going to happen there. Comps are very easy right now in terms of as we go forward. But then again, what does the future portend? I think the political situation there is very questionable.

And then the same is true as you get into Turkey and some of the other Middle Eastern countries. And so in India, again, we don't have much in India but India is a good place to be right now from an economic perspective. Hopefully that is helpful.

Operator

David MacGregor, Longbow Research.

David MacGregor - *Longbow Research - Analyst*

Thanks for taking the question. I wanted to ask you about Europe and the 11% organic growth. Pretty impressive as you pointed out against the year-ago compare. Can you just unpack what is going on there for us and help us understand some of the drivers behind that? And also maybe just talk about the extent to which expanded distribution is growing that versus same-store sales?

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

I will take that one. Yes, as both Jim and I mentioned in our comments, we are very, very pleased with the organic growth profile that we have seen in Europe. And frankly, this is a trend that has been going on for almost three years now. We have seen really consistent anywhere from mid to high single digits organic growth. This quarter was 11% so even better in low double digits.

And I think when we look at it, it started out as some revenue synergies that came out of the Stanley and Black & Decker merger that we really were leveraging and having a positive impact in that region. Then we started getting deeper into SFS 2.0 and some of the commercial excellence efforts. Now we are getting into the digital components of that with digital marketing and the more e-commerce activities over there. And then you combine that with the fact that with new technologies like brushless as an example in the cordless power tool space, an innovation that we brought to the marketplace, we have created an opportunity to fill a lot of white space within a certain base of our customers. And so we have been able to fill that white space and put fourth different products.

The other item I didn't mention was also putting the Stanley FatMax brand on mid- price point power tools in Europe. So that was another opportunity that was leveraging the effect of synergies of the two companies. And Europe is probably the best example and then maybe emerging markets after that of a combination of the revenue synergies from the merger and then the great benefits that we are starting to see in the first couple of years from SFS 2.0.

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

And also the talent, the talent that we have picked up when we did the merger with Black & Decker, I put my European team in Tools up against any team in the company in terms of their passion, their commitment, their competency and their ability to perform. So human element is part of that too.

Operator

Dennis McGill, Zelman & Associates.

Dennis McGill - *Zelman & Associates - Analyst*

Good morning. I was hoping if you guys had a chance on the Security side, I guess maybe in particular electronics, just give us an updated view on where you think you are on some of the operational improvements? Good margin this quarter and I think a good trajectory but not sure, Don, if you want to just think through not necessarily to next year but over the next couple of years, how far into the operational improvements are you? Then if you can maybe split the comments between North America and International, that would be helpful.

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

Sure. I think we are if you relate it to a baseball game, I think we are probably still in maybe the fourth inning at this point related to our progress. We are very pleased as we mentioned in our comments, mine in particular about the progress that we are seeing in North America. Europe made great progress over the last two years but now Europe is kind of hitting the threshold of being close to 10% profitability and then taking it to the next step which is closer to the low to mid teens. That is harder work and it takes more effort and you also have to have a continued topline organic growth performance to get some leverage effect as well.

But I think each region has make great progress. The Europe journey, the improvement has been going on a little bit longer than in North America but I still see at this point we are probably going to end the year close to 13% profitability for this segment, probably just under 13%. And at this stage we still see a path for it to get to close to 15% as we communicated back at our investor day in May of 2015. And we are probably two to three years away from achieving that objective.

Because we are continuing to do a lot of heavy lifting and one of the value proposition items that we see in electronics security is the ability to really differentiate with customer service and that is what the teams have been focused on for the last year or two. But we still see a world of opportunity in that space to make it better and better which is only going to enhance our productivity as time goes on.

Operator

Josh Chan, Baird.

Josh Chan - *Robert W. Baird & Company - Analyst*

Good morning, Jim and Don. Just wanted to ask about the retail sellthrough at the Tools and Storage business maybe excluding the FLEXVOLT launch? Some of the companies that kind of sell to the same customers have kind of noted a slower July and then trends improving as the quarter progressed. Just wondering what you saw in terms of POS and if you have any comments into the first couple of weeks of October? That would be great. Thank you.

Jim Loree - *Stanley Black & Decker Inc. - President and CEO*

Our POS, at large retail as literally been spectacular in the beginning of the year. In the close to 10% kind of zone for a period of time. Then as the year went on, so let's say beginning sometime in the second quarter started to sequentially get lower and it never really got really low and it was always positive but it was definitely trending sequentially lower up until the FLEXVOLT launch. And at that point, we have seen it begin to track sequentially higher. And where we stand on weeks of sale in total is the weeks of sale are substantially lower right now than they were last year. And I think part of that has to do with good sellthrough, and increasing sellthrough maybe even beating expectations of the retailers. But I think also there is an element of structural change that is going on with supply chains at some of the major retailers. So hopefully that gives you some color on POS and sellthrough.

Operator

I'm showing no further questions at this time. I'd like to hand the call back over to Mr. Greg Waybright for any closing remarks.

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

Nicole, thank you. We would 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.

Operator

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