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SWK - Q2 2017 Stanley Black & Decker Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 revenues of $3.2b and adjusted EPS of $2.01. Expects 2017 adjusted EPS to be $7.18-7.38.

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PRESENTATION

Operator

Welcome to the second-quarter 2017 Stanley Black & Decker earnings conference call. My name is Shannon 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 the Vice President of Investor Relations, Dennis Lange. Mr. Lange, you may begin.

Dennis Lange - *Stanley Black & Decker, Inc. - VP of IR*

Thank you, Shannon. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's second-quarter 2017 conference call. On the call, in addition to myself, is Jim Loree, President and CEO; Don Allan, Executive Vice President and CFO; and Greg Waybright, Vice President of Investor Relations.

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 app. A replay of this morning's call will also be available beginning at 2 p.m. today. The replay number and the access code are in or press release. This morning Jim and Don will review our second-quarter 2017 results and various other matters followed by a Q&A session.

Consistent with prior calls, we are going to be sticking with just one question per caller and, as we normally do, we will be making some forward-looking statements during the call. Such statements are based on assumptions of future events that may not prove to be accurate and, as such, they involve risk and uncertainty. It is therefore possible that the actual result 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'll now turn the call over to our President and CEO, Jim Loree.

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

Okay, thank you, Dennis, and good morning, everyone. Thank you for joining us. As you saw from this morning's news release, Stanley Black & Decker reported a strong second quarter and thus a solid first-half as well. Each of our business segments contributed to robust organic growth, which was an impressive 7% for the quarter.

Our team's continued focus on delivering top quartile financial performance, innovative products and solutions for our customers along with outstanding execution resulted in a revenue increase of 10% to $3.2 billion. Results included a full quarter contribution from the recent Newell Tools and Craftsman brand acquisitions, which supplemented our strong underlying organic growth.

Tools & Storage led the way in total growth, up 17%, up 8% organically. We believe about 2X the market with all regions once again contributing to the continued growth and share gain. The FLEXVOLT battery system continued its steady march to $300 million, making it the largest, fastest-growing cordless launch in our industry's history.

Our Tool business keeps delivering and exceeding expectations through commercial and operational excellence, including outstanding core and breakthrough innovation, while at the same time integrating two major transactions. 2017 is shaping up to be another superb performance by the entire global Tools & Storage team.

The Industrial segment also delivered a significant out-performance for the quarter. Organic growth accelerated to 9% on the heels of 4% growth in the first quarter. In Engineered Fastening we continue to see strong automotive systems sales in addition to higher industrial volumes, which supported an impressive 6% organically for the quarter.

Our other industrial businesses, Oil & Gas and Hydraulic Tools, or infrastructure, each delivered 19% organic growth, outstanding performances, as commercial actions plus positive underlying markets benefited both the project and inspection activity within Oil & Gas and expanded Hydraulic Tools' volumes.

And finally, our Security business grew 2% organically, slightly ahead of our expectations. North America Security generated 4% organic growth on stronger installation project activity within the commercial electronic security and automatic door businesses. It is rewarding to see the commercial and operational efforts from the North American Security team manifested in the results.

It is noteworthy to point out that this is the highest quarterly growth performance for Security North America since the fourth quarter of 2014. Our overall Company operating margin rate remained robust at 15.7% excluding M&A-related charges, relatively flat to the post merger record rate in the second quarter of 2016, and a nice step up of 150 basis points sequentially.

The benefits of operating leverage and productivity enabled us to essentially offset modest inflation, price and currency while we continue to make focused investments on our property system, SFS 2.0. These investments will support future innovation, organic growth and margin expansion.

Adjusted EPS for the quarter was $2.01, which is a 9% expansion versus prior year. It was fueled by strong operational execution by our business teams. So, a really great quarter and an excellent first-half of 2017.

And I want to thank all of our teams around the globe for their energy, enthusiasm and engagement as well as their passion for high performance and results. And based on the Company's first-half organic growth performance and our confidence in the outlook, we are raising 2017 full-year adjusted EPS guidance range by $0.10 to $7.18 to $7.38.

Now turning to an update on the recent acquisitions, importantly our progress on integrating the Lenox, IRWIN and Craftsman brands into our portfolio is progressing nicely. We remain on track to meet our expectations both from a financial and integration execution perspective.

Specific to Newell Tools, there were some notable accomplishments in the quarter as we continue to assimilate employees, suppliers and customers into our existing operations. In this regard we are deploying core SFS principles into the production facilities and have begun moving order fulfillment into our Tools & Storage distribution centers, which included a major retail customer implementation in the second quarter.

The Lenox and IRWIN teams are embracing SFS and are energized now to be part of a larger highly committed tool business. Our commercial teams are in the process of building plants to support revenue synergies and remain optimistic that a meaningful contribution in that area is ahead of us. In fact, during the second quarter we have already begun realizing a modest amount of revenue synergy within the emerging markets.

Finally, as always the business teams are working diligently to plan and execute the cost synergies. In this case $80 million to $90 million. Turning to Craftsman, we are hard at work developing commercial strategies for this iconic powerful brand and remain confident in our ability to achieve approximately $100 million a year in incremental annual revenue growth for the foreseeable future.

Our customer discussions are continuing and are going well as we plan for a mid-2018 Craftsman launch outside of Sears. From a supply chain perspective, we have started up a new distribution center in Charlotte, North Carolina and are aggressively moving supply and customer fulfillment into this facility to support the Craftsman business.

As you can tell, there is a large amount of momentum and continued enthusiasm for both of these transactions as the theoretical strategic value of these assets becomes more tangible and more real with every passing day.

One last item I'd like to call your attention to is last week's dividend announcement. We increased the quarterly dividend by approximately 9% to $0.63 a share. I am proud to say that this will be our 50th consecutive year of increasing the dividend and it is a reflection of our continued commitment to deploy approximately half of our excess capital to shareholders and half towards M&A over the long-term.

I'll now turn it over to Don for a more detailed assessment of the second-quarter results.

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

Thank you, Jim, and good morning, everyone. I will now take a deeper dive into our business segments which delivered another strong performance in the second quarter.

Starting with Tools & Storage, revenues were up 17% in the quarter due to 8% organic growth and an 11 point contribution from acquisitions, which were partially offset by 2 points of pressure from the combined impact of currency and divestitures. The operating margin for this segment was robust at 18.1% as the benefits from volume leverage and productivity were more than offset by growth investments, price and inflation, resulting in a 70 basis point decline in rate versus last year's quarterly record rate.

Once again each Tools & Storage region and SBU posted positive organic growth in the quarter. On a geographic basis, North America led the way up 9%. This strong performance was broad-based as we saw high-single-digit growth in our US industrial and commercial channels and low-double-digit growth within U.S. Retail, which includes our e-commerce customers.

Additionally, Canada posted solid organic growth of 7%. The growth continued to be supported by new product introductions, which includes contributions from FLEXVOLT. I will provide a bit more color on FLEXVOLT in a few minutes.

North America POS data was up mid-single-digits, which is very impressive as it comped against mid-teen POS growth rate from the prior year. Additionally, inventory within our major customers were at or slightly below prior-year levels, which gives us confidence that our growth has been supported by strong sell through in the channel.

Europe delivered another above market performance with the region posting 8% organic growth. Nearly all markets contributed with double-digit performances in the UK, Benelux, Iberia and Eastern Europe. The European team continues to be the model in our Company for commercial excellence. The team has found ways to leverage our broad stable of brands and manufacturing footprint to deliver differentiated solutions for our customers.

Finally, the emerging markets were supported by solid performances across Latin America and within Russia, India and Africa, which contributed to overall organic growth of 3% in the quarter. As noted last quarter, we have completed a transition to a direct model in Turkey, which in future periods should no longer be an inhibitor to growth. If we exclude the Turkey transition organic growth would have been 6% for the emerging markets in Q2.

Performance within Latin America varied as double-digit growth in Mexico, Brazil and Ecuador more than offset declines in Colombia, Chile and Peru, a trend we have seen throughout most of 2017 and is reflective of unique country market conditions. Diligent pricing actions as well as the ongoing MPP launch across the developing markets are continuing to drive growth.

Additionally, we have seen the e-commerce channel increase its share of the market and become a larger contributor to our growth within emerging markets. As you know, we have what we believe to be leading positions in e-commerce in the developed markets and we are leveraging that know how as our emerging markets teams work to develop this critical channel over time.

Within the Tools & Storage SBUs all lines were positive in the quarter. The power tool and equipment group was up 10% led by professional power tools as well as contributions from the outdoor and home products segments. This SBU also benefited from new product innovation including FLEXVOLT and continued strong commercial execution.

We had another strong quarter for the FLEXVOLT products with approximately $60 million in revenue. Based on year-to-date results and planned second half FLEXVOLT product launches, we still believe that we are on track to deliver revenue approaching $300 million from FLEXVOLT in 2017. When factoring in cannibalization, however, this represents $200 million of SBD revenue or $100 million of growth versus the prior year.

Our hand tools, accessories and storage organization delivered 5% growth on new product introductions and benefited from a strong performance within the North American industrial end markets led by our Mac Tools business.

So in summary, the Tools & Storage organization continued its momentum in the second quarter delivering strong above market organic growth along with robust operating margin of 18.1%. At the same time there was relentless focus on acquisition execution around the Newell Tools and Craftsman brand, as Jim referenced earlier.

Now moving to the Security segment, Security had a solid second-quarter as well posting 2% organic growth. North America organic growth was up 4% led by higher installation volumes within the commercial, electronic, security and automatic door businesses. Europe was flat organically in the quarter as gains in the Nordics and the UK were offset by declines in France.

In terms of profitability, the segment contracted 150 basis points year over year, which was in line with our expectations. The sale of the mechanical locks business drove approximately 120 basis points of this contraction.

The remaining 30 basis points decline was attributable to higher levels of installation growth within the quarter, country mix within Europe, and a modest level of investment to support future growth. The Security team is maintaining its focus on commercial and operational effectiveness to position this business for future revenue growth and margin expansion.

Finally, the Industrial segment had an impressive quarter of outperformance as both the Engineered Fastening and Infrastructure businesses delivered strong organic growth well in excess of expectations. This top-line performance contributed to a 240 basis point expansion and operating margin rate due to the benefits from volume leverage, productivity and previous cost actions.

Engineered Fastening posted 6% organic growth as the automotive business, up low-double-digits, and a return to our growth in our Industrial business more than offset lower electronics volumes. From an automotive perspective the growth was led by shipments of our self piercing rivet and stud welding systems to support our customers' new model launches.

Auto fastener sales outpaced light vehicle production by approximately 300 to 400 basis points, showing that we continue to deliver content gains.

Finally, the Industrial business delivered approximately 2 points of organic growth affecting more robust market growth and commercial actions executed within the business.

As Jim mentioned, the infrastructure businesses posted an exceptional quarter, up 19% organically. Our Hydraulic Tools business is reaping the benefit from its revamped commercial structure and go-to-market strategies with a backdrop of modestly higher prices in the scrap steel market, which does benefit our product lines. Hydraulics posted 18% organic growth in its third consecutive quarter of organic growth with higher volumes in all regions.

Meanwhile Oil & Gas also generated 19% organic growth in the quarter, well ahead of expectations, as the industry benefits from an acceleration of onshore pipeline construction activity within North America in the first half of this year. This is being offset by continued low offshore project activity.

While the results of the Oil & Gas business are encouraging, our expectation is that without resumption of approvals by the Federal Energy Regulatory Commission, also known as FERC, we will see a return to lower level of project activity in the second half of this year.

We are pleased by the performances across the portfolio thus far in 2017. We will remain focused on driving outsized organic growth and operating leverage while integrating the Lenox, IRWIN and Craftsman brands within our Tools & Storage franchise.

Let's take a look at the quarter's free cash flow performance on the next page. For the second quarter free cash flow was $134 million, which brings our year-to-date performance to a use of cash of $76 million. The quarterly and year-to-date declines versus the prior year are predominantly explained by carrying higher amounts of working capital relative to the outsized level of organic growth we were experiencing primarily within the Tools & Storage business.

From a working capital turn perspective we delivered 7.1 turns in the second quarter, which is a decrease of 1.1 turns versus the prior year. This decline is primarily due to the impact of our recent portfolio activity, specifically the acquisition of Newell Tools and the Craftsman brand. This decline is primarily due to the impact of our recent portfolio activity, specifically the acquisition of Newell Tools and the Craftsman brand.

Excluding these acquisitions we were down 0.3 turns versus the prior year. We are confident that we will deliver strong cash flow generation in the second half of the year given our core SFS processes and principals combined with focused execution on reducing working capital levels in line with Q4 seasonal activity. In addition, we will continue to ensure that we maintain an adequate amount of working capital to support our growth expectations.

As a reminder, in 2016 we improved our working capital turns from 8.2 times up to 10.6 times in the second half of the year. In 2017 we expect a similar working capital turn improvement within the second half from 7.1 times up to approximately 9 times by the end of the year.

Therefore, we are reiterating our commitment to deliver 100% free cash flow conversion supported by this expected strong second-half cash flow generation. As a reminder, this free cash flow conversion guidance excludes the impact of gains on divestitures.

So turning to our 2017 guidance on slide 7, as Jim mentioned earlier, we are also raising our adjusted EPS outlook range for 2017 to $7.18 up to $7.38, which is an increase of 10% to 13% versus the prior year. On a GAAP basis this results in $8.05 to $8.25 earnings per share range, which is inclusive of various one-time charges and the gains from the first-quarter divestitures.

The $0.10 increase to our outlook range is a result of higher organic growth than previously expected, about half of which was delivered by the businesses in the second quarter and the remaining half is expected to occur in the balance of the year. Additionally, we are maintaining our combined FX and commodity inflation headwind estimate of around $100 million to $105 million.

While currency pressures have reduced since the first quarter, we are seeing increased pressures in commodities, namely steel and some purchase components. I would also like to point out that we expect third-quarter EPS to approximate 25% to 26% of the full-year 2017 EPS guidance.

Now turning to the segment outlook on the right side of the page, organic growth within Tools & Storage is still expected to be mid-single-digits, but modestly improved versus our last outlook. We see healthy construction markets in the US combined with continued stable European environment and a modestly improving emerging-market set up to continue through the remainder of the year. This should provide the backdrop for share growth when combined with our commercial actions.

We continue to believe that top-line growth will translate into an improved margin rate year over year. We are maintaining the organic growth view on Security up low-single-digits in 2017.

Note that the margin rate for this segment will be down year over year due to the divestiture of the mechanical locks business which occurred during the first quarter. However, excluding that sale the margin rate for the year will be flat to slightly down as we expect the impacts of mix and investments to support growth have the potential to be modestly dilutive to the full-year rate.

Now finally in the Industrial segment, we still expect organic growth to be relatively flat, but modestly higher than our previous expectation. While we did see out-performance in both Engineered Fastening and Infrastructure again in Q2, as I discussed in the April earnings call, there are market-related pressures which are expected to emerge in the second half.

These pressures fall into three areas: one, North America light vehicle production is expected to soften; two, automotive systems which support customer new model rollouts will be lower in the second half of 2017; and three, expected lower project activity in North America for Oil & Gas as I discussed earlier. We continue to expect operating margins to improve in this segment driven by previously identified cost controls as well as the impact from the first half performance.

We believe we have a solid path to deliver the full-year revised guidance and outperform the broader market from an organic growth and margin expansion perspective. We will remain focused and disciplined in our pursuit of that goal in addition to successfully integrating our newly acquired tools businesses. With that I will turn it back over to Jim to summarize this morning's call.

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

Okay, thanks, Don. So to recap, the second quarter built upon the strong start to 2017. We continue to deliver above market organic growth and robust operating performance. As a result of the continued momentum we increased the EPS guidance and continue to be excited about the opportunities to deliver value from the recent acquisitions, which are on track.

And as we have moved into the second half now our deep and agile leadership team is leveraging SFS 2.0 to deliver organic growth with operating leverage, continuing to integrate the Lenox, IRWIN and Craftsman brands into our portfolio, and generating that strong free cash flow. And we are encouraged by the results through the first half and we are encouraged by our ability to raise the outlook for the full-year.

We are also vigilant in the pursuit of our three overarching themes -- to become known as one of the world's leading innovators, to deliver top quartile financial performance, and to elevate our commitment to corporate social responsibility, all of which supports the Company in achieving our 22/22 vision. Thank you and we are now ready for Q&A.

Dennis Lange - *Stanley Black & Decker, Inc. - VP of IR*

We can now open the call to Q&A please. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Nigel Coe, Morgan Stanley.

Nigel Coe - *Morgan Stanley - Analyst*

Thanks, good morning, Jim and Don. Interesting comment about the cannibalization on FLEXVOLT's $300 million growth, $100 million of cannibalization. I'm just wondering if you can maybe provide a bit more color in terms of where you are seeing that cannibalization.

What kind of margin mix you are seeing on FLEXVOLT versus the products that are being cannibalized? And then maybe just the second half of this year into 2018 how the product rollouts and store rollout looks for FLEXVOLT. Thanks.

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

Sure. So as I mentioned in my comments, we see a path now for FLEXVOLT to be approaching $300 million before cannibalization and the cannibalization impact will bring the number down closer to $200 million net overall for Stanley Black & Decker.

What we are seeing is that, as we have been communicating probably now for three to four months, is that we started seeing cannibalization in the spring, early springtime related to certain products that we were replacing on the corded side with FLEXVOLT technology. So we still offer those particular products.

However, when someone goes in to make a decision about a 120 volt product or 60 volt product that is now something they can get through FLEXVOLT, they have a choice to make between the FLEXVOLT technology or the corded DeWALT technology.

And so, as we anticipated, we expect to have a little bit of cannibalization and that's what we are experiencing. And we hope as we end the year maybe the cannibalization won't be as large as what we projected, but right now that's kind of what we feel the trend will be at this stage.

Operator

Jeffrey Sprague, Vertical Research Partners.

Jeffrey Sprague - *Vertical Research - Analyst*

Thank you, good morning, everyone. Just a question on Tools & Storage margin, and really kind of a two-part question. First, I was wondering if you could decompose in a little bit more detail the drivers, product spending and promotion, etc., in the quarter.

But then bigger picture, Jim, I was also wondering -- clearly you've got a balancing act between revenue growth and OP margin dollar versus margin rate. I was just wondering if you could put that in perspective for us, how you think you balance those two and maybe what is the normalized margin trajectory for the Tools & Storage business?

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

Yes, I will let Don tackle the first part of your question, which I'm not sure he can add too much more color to, but we will have him address that in a minute. I will just take philosophically, or from a big picture perspective, when we are pulling those levers on price promotion and margin optimization, trying to figure out where the sweet spot is, I would say we tend to go in cycles sometimes. And the needle will move from one side of the spectrum to the other a little bit.

And I would say in the second quarter in particular we probably were a little bit more aggressive on price than normal and so you saw the negative 1% price for the Tools segment. That is not something that I necessarily see as a sustainable approach, but it was more of a bit of some experimentation, especially since our regular promotional activity in the second quarter was a little bit lower.

So we had a fantastic margin performance in the Tools business, 18.1%. Somebody was commenting earlier before the call that, wow, it's down 70 basis points. Well, it's down 70 basis points versus our highest margin ever in the Tools business. So I wouldn't get too concerned about it. We had the flexibility to do some experimentation and we did.

I think you'll see a little bit more of a shift as we get into the second half, particularly the third quarter where we have more traditional type promotions as opposed to price-related promotions. And all of that price activity I would say is driven more by us in the driver seat as opposed to responding to anything in the marketplace. Don?

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

Yes, I wouldn't dramatically add anything to what Jim just said about price. I think that was right on the mark. But I will reinforce that this is probably, if not the second or third highest profitability quarter Tools has ever had, I think it's the second highest they've experienced after last year's second quarter of 18.8%.

And so, we just have to keep that in mind and recognize that we are also experiencing some commodity inflation pressure as well and yet we are still able to achieve that level of profitability, and that we don't turn it into something any more significant than what it is, which is relatively insignificant.

I do want to make a comment on -- I didn't answer Nigel's second question about the profitability related to the shift of cannibalization in FLEXVOLT. And it really is not much of a significant impact. It's a little bit of a negative initially here. As we have said before, the FLEXVOLT margins are a little bit lower than line average throughout this year.

We expect as we go into next year for that dynamic to change as we have increased the volume. And we also will likely have lower promotional activity as well. But the impact overall is relatively minor and you can see that in the overall operating profit rate of 18%.

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

And I would also -- this is Jim. I would also like to say that -- congratulations to the operations team in Tools & Storage, they have done a fabulous job with productivity. We had a series of years where we had a Design to Value initiative going, which is now pretty mature.

But at this point we are starting to get in -- pretty significantly into industry 4.0. And that basically involves creating smart factories and then embellishing them with robotics and 3D printing and these types of things.

We are far from the robotics and 3D printing phase of it, but we are definitely making a lot of progress in making the factories more data-driven, more real-time in their execution. And what we are seeing is that we are getting above average -- above historical average productivity out of this and we expect to continue that as we go forward. So that's really helping boost the margins as well.

Operator

Rich Kwas, Wells Fargo Securities.

Rich Kwas - *Wells Fargo Securities - Analyst*

Hi, good morning, everyone. Just a couple of quick ones for me. On Security you talked about investment relative to the beginning of the year and the underlying margin. Was there any change in the underlying performance?

I know most of the decrease is coming from the elimination of mechanical locks, but if you could provide some more color on what has changed since the beginning of the year in terms of incremental investments for future growth versus underlying performance organically.

And then the other one real quick is, as you look at the second half of the year you have a big industrial electronics customer that is coming out with a new product. How should we think about impact to the top line as we think exiting 2017 and into 2018? I know that business has been under pressure for some period of time. Thanks.

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

Yes, as it relates to Security initially, no major changes to our thought process around investments. As we said at the beginning of the year, we are investing a little bit of funds within our Security business to develop a more consistent organic growth profile over the long term.

And we think we are starting to see a little bit of the benefits of that as we saw a quarter with 2% organic growth here within the second quarter. But there is more work to be done in that regard. So no major shift.

I would say there was certainly a little bit of mix pressure this quarter that maybe had a tenth or two-tenths of pressure on the profitability of the segment as we saw a little bit higher mix of installation revenue in the United States and then the country mix over in Europe also was a little bit of a negative, but nothing major.

So I wouldn't say there was anything really underneath that was causing a major shift that's something that's permanent or ongoing, it's just more of a unique second quarter type of situation.

As it relates to Industrial and electronics, that business for us has gotten down to a relatively small number here in 2017, so in the second quarter it was about $6 million of revenue. It's a very small component of that business at this stage for that particular customer.

We don't expect to participate in a significant way in the launches in the back half. We have a minor roll with that customer on an ongoing basis and we actually like that position given the volatility and the profitability of the business.

Operator

Michael Rehaut, JPMorgan.

Michael Rehaut - *JPMorgan - Analyst*

Thanks. Good morning, everyone. Just a quick clarification in my main question. The clarification is just on the Tools & Storage. I was just curious on the growth investment and basis point impact on the margins to just try and get a little better sense of the underlying core margin, let's say, in that business as growth investments eventually will moderate as I guess you get other -- FLEXVOLT and your other acquisitions more fully running.

And then just on the -- the main question though on the -- a little bit more detail hopefully on the change in -- what's driving the change in sales growth guidance. You mentioned Tools & Storage and Industrial a little bit better than the last time. And I'm sorry if I missed it, but just a little bit more of where that's coming from in both segments?

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

Sure. So I think on the growth investment side for Tools, that's not a simple number to quantify because there's a lot of different investments across the Tools business that are made to stimulate growth in the core business, to stimulate FLEXVOLT. So, it's difficult to really say how much new growth investments are.

What I would say is that there are continues to be areas that we want to pursue to make investments for future growth and to experience a type of growth that we've had in this business that's high-single-digits, anywhere from mid- to high-single-digit organic growth on a consistent basis, we have to be making some investments along the way to ensure that that type of trend continues at least in the midterm. And that's really what you are seeing in the business.

Now that being said, to all the points we made earlier, the profitability of the business continues to improve. And so, we would expect that when we look at the year-over-year performance of Tools here in 2017 versus 2016, we will probably see 40 to 50 basis points of improvement in the margin rate year over year while we are making investments, while we are making other decisions.

Because of some of the things that Jim mentioned around productivity, because of other cost management and different areas outside of growth investments. All those different things allow us to manage the business in a certain way and get to a certain result.

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

And that's a really important point, Don. Because that's philosophically what we're trying to do is that we are trying to achieve top quartile organic growth and fueling that with investments and at the same time driving margin expansion. And that's not easy to do, as Don points out. But that is really philosophically what we are trying to do.

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

And the other question was related to change in the organic growth guidance assumptions. Yes, we have tweaked our -- as I mentioned in my comments on the call, we have tweaked our assumption for Tools & Storage up a little bit versus what we said in April and the same thing would be true for Industrial.

Now Industrial's reason is more because we saw stronger performance in the second quarter than we were thinking in April. Tools is more of a continued trend of modest out-performance in their organic growth versus expectations and then a slightly --.

Certainly as we get to July every year for our Tools business we get a really nice view of the back half of promotional activity, the beginning of the holiday season. And so, that gives us something that we can get a better sense of what we think organic growth will look like. So based on those various factors is why we tweaked those numbers up.

Operator

Tim Wojs, Baird.

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

Hey guys, good morning. Nice job.

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

Good morning, thank you.

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

I guess my question is really on Craftsman. I think -- I just wondered, Jim, if you could talk a little bit about maybe the scheduled launch in the middle of 2018. A little bit of color on maybe which products, any sort of dialogue you are having with customers. And then maybe more broadly, any change to how you guys or your customers are thinking about e-commerce at this point?

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

Well, there's a lot of really good things going on relative to Craftsman. I don't want to get into too much detail because it is a competitive situation.

But I will tell you that we are working on designing a complete comprehensive product line that spans all categories, that it will be a high quality product line that is high-quality, high-value for the customer and will take some of the best attributes of our high-value products from across all our brands and incorporate them into the designs. The channel discussions, the customer discussions are going very well. The interest level is very high.

We haven't really changed too much in terms of our strategy. There will be some decisions made in terms of how we expect to go to market from a channel perspective in the third late third-quarter, early fourth quarter. And then it will be all systems full speed ahead for a mid-2018 launch.

Operator

Joe Ritchie, Goldman Sachs.

Joe Ritchie - *Goldman Sachs - Analyst*

Hey, good morning, guys. So maybe just touching on the FX and commodity headwinds of $100 million to $105 million that you had forecasted for the year. Maybe if you could talk a little bit about whether the pressure you saw in 2Q was more or less what you anticipated. And then just a little surprised that we are keeping that at the same number just given FX has probably moved more positively for you as the year has progressed. So any comment on that would be helpful.

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

Sure. I will take that and, yes, so we started the year with an estimate of around $100 million in total for those two items as a headwind and at that time it was about 50/50, so 50% for FX and 50% for commodity inflation.

Back in April it had shifted more to 60/40, 60% being commodity and 40% being the FX. In the second quarter that shift continued where now we think, based on current rates, we are probably around $25 million of that $100 million is currency and the remaining $75 million is commodity inflation.

And so, we've seen a continued trend of commodity inflation creeping up through the first six months of the year. We feel like at this stage for the remainder of the year we have our arms around that with various contractual situations with key suppliers that we think we can manage that through the remainder of the year within a relatively small number. So we don't expect that trend to continue.

And if FX continues to go in the direction it has been there might be a potential for that $100 million to be a little bit smaller by the end of the year. But we will see how things progress at this stage. But that gives you a little bit of the evolution of the history and where we are today.

Operator

Robert Barry, Susquehanna.

Robert Barry - *Susquehanna Financial - Analyst*

Yes, hey guys, good morning. Just I guess a couple questions on Tools volume and to reference your comment earlier on pricing experiments. How much volume do you think you picked up in Tools this quarter with the price ticking down, one? And then just a follow-up on the FLEXVOLT comments.

It seems like the broader Tools business is doing better and the momentum there is better. It seems like the outlook for FLEXVOLT should be sharing in that to the extent that the end market is helping there. Any comments there on just how you are thinking about that outlook for FLEXVOLT versus the broader Tools market?

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

We haven't changed our outlook for FLEXVOLT pretty much all year. We have been consistent with that $300 million minus the $100 million for cannibalization and feel good about that.

We have a whole family of new SKUs coming out here in the next couple months that's going to support continued growth in FLEXVOLT against comps that begin to get tough -- start to get into the September, October, November, December timeframe.

So, and Don I think hit the cannibalization subject pretty hard earlier. So I think FLEXVOLT is a good story. It's going to be really good and it's going to be supportive of a $300 million number gross. And we will see what happens when the new SKUs come out and if they are really successful that will be even -- it will be great. And then we the fact that we have no answer yet in the marketplace to FLEXVOLT and we are almost a year in now.

And so this is about building an installed base. A battery system is about an installed base. And getting that installed base built means that it creates the foundation for future growth and future expansion. And if you recall, the whole concept of FLEXVOLT is to eliminate cords from the job site. And the more SKUs we can come out with over time where people use that battery system will be a definite competitive advantage here as we go forward. So we are very excited about FLEXVOLT.

We are thankful that the innovation was protected well enough so that it could not be leapfrogged in short order. And I think it would be foolish to think that sooner or later a competitor or competitors won't come out with an answer of some sort. But the answer we've seen so far, which is 9 amp hour 18 volt, clearly has not been the answer to FLEXVOLT.

Going to how much did the 1 point of negative price drive volume in Tools I think the volume has been pretty steady in that 5% to 7% range all year, and frankly for quite some time. And I think it's probably safe to say that maybe we got a point out of it or something like that at most. And so, the conclusion we've drawn is that the business runs nicely at a 5% to 7% kind of threshold or range of growth.

And when we start pushing it up into the 8%, 9% range in total it starts to put strain on the factories and the supply chain and freight and costs and things like that. So we're probably better off running it in the 5% to 7% range to the extent we are able to do that without any significant pricing promotion in that regard.

So I think that's pretty much about what we can say about the experiment. We are excited about the third-quarter promotional calendar which is something that we normally do in the second quarter. And so, stay tuned.

Operator

Chris Belfiore, UBS.

Chris Belfiore - *UBS - Analyst*

Good morning, guys. Yes, just have a follow-up to that commentary and question. I mean in terms of just the back half for Tools & Storage, a little bit better than mid-single-digit.

Just trying to figure out where -- it seems like it needs to kind of slow down from a volume standpoint. But like you just said, there's promotional things going on in the third quarter too. So how like price and volume pair out in the second half, just color on that?

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

Certainly the comps are getting tougher as we get into the back half of the year, so we have to keep that in mind. But based on our current outlook you are probably looking at a second-half that's going to be around 6% organic growth for Tools & Storage.

So it's kind of right in the middle of that -- as Jim just described, the sweet spot of the business currently today runs very well in that range of 5% to 7%. It might have a slight slant to 7%, we will see how the year ends up. But is kind of in that range of 6%, maybe up to 7%.

Operator

Josh Pokrzywinski, Wolfe Research.

Josh Pokrzywinski - *Wolfe Research - Analyst*

Hi, good morning, guys. Not to beat FLEXVOLT to death, but I guess could you just, Jim, run us through some of the thoughts on cannibalization just given that the dollar mix or I guess the price point is so much higher for FLEXVOLT versus corded? And I think even on the battery line much higher as well.

And maybe try to weave some of the commentary about inventory turns and that since I think a lot of what you saw last year, and even in the early part of this year, has been mostly channel fill versus turn. So just how are those turning through the market? And I guess like I said before, how is that factoring into the price mix on FLEXVOLT relative to that cannibalization number?

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

First of all, let there be no confusion that the sell through on FLEXVOLT is excellent and really is not about growing inventory in the channel. The early first month or two obviously was sell-in as a result of start up of an initiative. But the sell through has been excellent and continues to be very strong.

So let me just put that one to bed. I think the one point that you really -- you hit it on the head with FLEXVOLT is this is about share of wallet when it comes to cannibalization. And you have two wallets, you have the end user's wallet and you have the channel wallet. And that's what makes it so difficult to really predict what the cannibalization will be because, at the end, there's only a finite demand for power tools.

And there are competitive power tools out there and then there are our power tools and there's FLEXVOLT. We can't really analyze at this stage, and may never be able to fully analyze what the impact is on cannibalization because of those various share of wallet items. And I think the thing you hit on the head was that FLEXVOLT is more expensive.

So to the extent that people are buying more units of FLEXVOLT they are more challenged to buy units of the 20 volt or 18 volt type products in the marketplace. So I don't think there's any clear or easy answers to the question, but what we are doing is to monitor this we are actually looking at point-of-sale in the non-FLEXVOLT areas, corded and cordless.

And we haven't seen any dramatic decreases at this point in time but I think we do see some decreases at the margin and that's what we can't really quantify. So we will keep an eye on it. We will report back as we learn more and more, we do more analysis over time. But it's going to take several quarters before we can really pin down exactly what the impact is.

Operator

Ken Zener, KeyBanc.

Ken Zener - *KeyBanc Capital Markets - Analyst*

Good morning, gentlemen. Taking that same line of questioning and adjusting a little bit given your comment, Jim, that's a finite universe in terms of the SKUs. Redefining the market is something Stanley has done very well and DeWALT in its history did very well.

But ever since your Analyst Day I've been just constantly referencing back to Jeff Ansell's discussion around what FLEXVOLT is and where can it go. And the idea that you are targeting small gas engines is something that is resonating with me. Not only because that's a new market for you, but also because of the savings you generated through the Black & Decker acquisition your margins today are nearly double a lot of your peers.

So, are you too busy with Newell, with Craftsman to consider that proposition? What are your limits I guess, because that's the real story behind Stanley is going into new categories, leveraging your operating platform versus others and acquiring a brand that's already established. Thank you.

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

First of all I would say that Craftsman brought many positive elements to the table. One of them is that it's complementary to exactly what you are talking about. Because prior to Craftsman we did not have a large gas engine or small gas engine lawn equipment power initiative. We did have the string trimmers and those types of things, but they were electric. So this gets us into gas.

And we are learning a lot about lawn and garden as we speak and we are experimenting with the application of DC brushless electric motor technology to lawn equipment. We do think there is a big future there. But there are some technological breakthroughs that will have to occur relative to the cost of doing that. And so, there's a lot of work going on there. And the answer to the question are we too busy with Craftsman; actually this is part of our busy-ness with Craftsman.

Operator

Scott Rednor, Zelman & Associates.

Scott Rednor - *Zelman & Associates - Analyst*

Hi, good morning. I had two quick questions on the Tools & Storage segment. First, on the Newell side I think you guys alluded to a retail load in. And I just wanted to clarify that the prior guidance had no revenue synergies embedded in it. And then secondarily, your largest domestic customers, at least their stock prices have been impacted by some of the e-commerce plays that have unfolded in the home improvement category.

Given that you guys sell to e-commerce as well as these large retailers, I was just curious to get your view on if you think the pie in power tools as well as overall home improvement is big enough for an e-commerce entrant as well as the legacy home centers to survive as you look out?

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

I will take part two. Don can figure out a little bit more about part one and probably ask a little clarification on that, but let me cover part two. So we as the largest tool Company in the world, as Don mentioned earlier, have taken a pretty aggressive stance in terms of making sure that we participate in the e-commerce opportunity and I will call it a transformation.

And of course e-commerce has its limitations; however, we would be foolish to think that it's not going to be a substantial part of the market in the years to come. It already is a substantial part of the market.

And as was mentioned earlier, we back in 2010 elected to enter the e-commerce market in the US and we did it not only with traditional e-commerce players or player, but also our traditional customers and especially the home centers. And the traditional home centers are forces to be contended with as it relates to e-commerce.

My guess, I would never ever comment upon the health or survival of our large customers, but I would say that both home centers embrace e-commerce and I think they have certain advantages and certain disadvantages relative to pure e-commerce players. And therefore, without getting too much into those, but you think about omni-channel and the advantages that brings and you look at the recent purchase of Whole Foods and you scratch your head and say why did that happen.

I think if you start to envision how omni-channel could play an important role in e-commerce you could see an unfolding scenario that says there can be successful pure players and successful omni-channel players. And maybe it all gravitates towards omni-channel at some point.

So I think there probably are going to be lots of changes as time goes on. We are really well-positioned; largest e-commerce player in the tool industry by an order of magnitude -- probably as much as an order of magnitude. And have developed skills and capabilities that we share readily with all our customers that are interested.

And now, as Don mentioned earlier, also internationally into the developed countries in Europe and other developed countries in the world and the developing countries. And I think in the developing countries what's interesting about e-commerce is that it will enable us in certain areas, such as China, where we don't have number one market share, to take a fresh look at how does one go to market in that type of a -- with that type of an opportunity to leapfrog maybe traditional distribution channels.

So very, very interesting space. We have done a lot of analysis and review of e-commerce in the last year or so. We are very comfortable with our strategy there. And we look forward to that being a major growth driver for us as we go forward across our customer base.

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

So the first question you had I think was around -- Jim made a comment in his opening remarks about Newell and moving certain inventory from one DC to another. And that was really just part of the integration plan. There was no load in to a customer. You might have misinterpreted those comments.

It was really moving from one of our DCs to another to improve the service fill rate levels. Because when we initially acquired Newell fill rates were much lower than what we would want them to be. And so we have been aggressively -- the Tools & Storage team has been aggressively working on this since the first day of acquisition and has made significant progress in that regard.

But there hasn't been any load in or anything into our customers related to Newell products. It's simply part of the integration, something that we had in the plan before the closing occurred. If that doesn't answer your question feel free to call Dennis and Greg and they can clarify anything else you had.

Operator

Michael Wood, Nomura Instinet.

Michael Wood - *Nomura Instinet - Analyst*

Hi, thanks for taking my question. I'll just shift gears to Security. Now that you've made your strategic decision there for the segment, just curious if there's opportunity to tweak any country-by-country exposure or are you happy with that portfolio now?

And also if you could just give some comment on the 2% of the acquired recurring business if that was opportunistic or if we should expect that to continue going forward.

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

I will take that one initially and Jim can add any color on the first part of your question. Right now we actually feel pretty good about the country makeup of the Security business. We don't see any countries that are major concerns for growth and profitability. We do watch that on an ongoing basis and evaluate it every year as part of our strategic update planning process.

There are a few small countries in Europe that over time we have to decide can we build a level of substance and infrastructure within those countries that make them a player where they're either number one or number two in the marketplace? Because we have a few smaller ones right now that are not in that position. If that didn't play out the way we wanted it to then that could be something we evaluate in the future.

The second part of your question, yes, we occasionally do these opportunistic RMR acquisitions in our Security -- electronic security business where we see them as nice additions to the portfolio. They will integrate right into our infrastructure and we will continue to look for those of the right price and the right financial returns.

Operator

David MacGregor, Longbow Research.

David MacGregor - *Longbow Research - Analyst*

Yes, thanks for taking the question and congrats on the good quarter. Just to pick up on the European -- or on the Security business, I wonder if you could just talk about the European Security business in particular. And you provided some outlook through 2017. But looking further forward into 2018, could you just talk about your growth prospects? And perhaps has something changed competitively?

And then if I could just add one quick one on. You called out Mac Tools as a source of strength. I know you added some storage product initiative there. Is that what's driving the growth or are you seeing something else that's driving Mac's growth? Thank you.

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

Yes, on Mac Tools we've just -- this has been an ongoing multi-year steady execution improvement. We have a difficult relative market share position, so it makes it that much more challenging. But we have added trucks, our sales per truck -- every year they are improving dramatically. And it's just kind of a slugfest over time, a steady slugfest. And even with all that we are getting mid-single-digit growth.

We had a pretty good quarter this quarter, a little better than usual. But it is basically three yards and a cloud of dust in Mac Tools. That's the way that business is for us. We love it, but it's not going to -- it's not going to be an 80-yard wide receiver touchdown in one quarter. And with that I will have -- Don, you can tackle the first part.

Don Allan - *Stanley Black & Decker, Inc. - EVP & CFO*

Yes, so Security Europe specifically around organic growth, we had said for Security in general, and it applies to Europe, is that we believe it's a business that right now, based on its current makeup, it can grow organically 2% to 3% on a consistent basis.

And Europe had demonstrated that type of trend up until this year where they'd seen a little bit of pressure in France, which is one of their larger markets that we think is just more market related and one time in nature in the sense of it's just really impacting this year.

But we still think that's the right growth prospect for this business both in Europe and globally. But more importantly, as you heard at our Investor Day back in May, we have to continue to work on the next evolution of Security which is getting into other areas that are very unique solutions that have specialized touch to a customer, have higher value and ultimately make that more positive mix to this business over the journey of the next three to five years plus.

And so, we need to do both of those things. But I think that's the type of thing that maybe could move the business beyond 2% to 3% organic growth. But right now that roadmap is not completely defined but certainly well underway.

Operator

This concludes the Q&A session. I would now like to turn the conference back over to Dennis Lange for closing remarks.

Dennis Lange - *Stanley Black & Decker, Inc. - VP of IR*

Shannon, thanks. We'd like to thank everyone for calling in this morning and for your participation on the call. Obviously please contact me if you have any further questions. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation. Have a wonderful day.