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## SWK - Q1 2019 Stanley Black & Decker Inc Earnings Call

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**OVERVIEW:**

SWK reported 1Q19 revenues of $3.3b. Expects 2019 GAAP EPS to be $7.50-7.70 and adjusted EPS to be $8.50-8.70.





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## PRESENTATION

**Operator**

Welcome to the First Quarter 2019 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.

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

Thank you, Shannon. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's First Quarter 2019 Conference Call. On the call, in addition to myself, is Jim Loree, President and CEO; Don Allan, Executive Vice President and CFO; and Jeff Ansell, Executive Vice President and President of Global Tools & Storage.

Our earnings release which was issued earlier this morning and the supplemental presentation which we will refer to during the call are available on the IR section of our website. A replay of this morning's call will also be available beginning at 11 a.m. today. The replay number and the access code are in our press release.

This morning, Jim, Don and Jeff will review our first quarter 2019 results and various other matters followed by a Q&A session. Consistent with prior calls, we're going to be sticking with just one question per caller, and as we normally do, we will be making some forward-looking statements during the call. Such statements are based on assumptions of future events that may not prove to be accurate, and as such, they involve risk and uncertainty. It's, therefore, possible that the actual results may materially differ from any forward-looking statements that we might make today. We direct you to the cautionary statements in the 8-K that we filed with our press release and our most recent '34 Act filing.

I'll now turn the call over to our President and CEO, Jim Loree.

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**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

Okay. Thank you, Dennis, and good morning, everyone. Thank you for joining us. As you saw in our press release, we delivered a strong start to 2019. The company posted solid quarterly revenue growth and overcame the carryover impact of commodity, currency and tariff-related headwinds to deliver modest earnings expansion.

First quarter revenues were $3.3 billion, up 4% versus prior year. This included a robust 5% organic growth and 3% from acquisitions, which were partially offset by a 4 point currency headwind. Price continues to materialize with 2 points of growth attributable to prices in the quarter. And Tools & Storage continued its impressive performance delivering 7% organic growth with all regions and business units contributing. The tools team is leveraging a powerful set of catalysts complemented by an intense focus on commercial execution to consistently deliver above-market growth. And once again, Craftsman, e-commerce, new product innovation and Irwin/Lenox helps propel the tools and storage performance. You'll hear more from Jeff Ansell on this during his remarks.

Industrial. Total revenues grew 10% as the Nelson and IES Attachments acquisitions were partially offset by automotive market pressure and currency. And Security demonstrated forward progress delivering both operating margin dollar and rate improvement versus 1Q'18. And the year into our 2-year strategic review process, the Security team has a strategy along with a detailed plan and is in full execution mode on the business transformation. Don Allan will provide some more color during his remarks, and we will cover it in depth at our May 16 Investor Day.

Adjusted EPS for the quarter was $1.42, up 2%. With a sharp focus on cost control, our business teams delivered a strong operational performance and overcame approximately $160 million of 2018 carryover headwinds in the first quarter. Our outperformance was very encouraging as we contemplate prospects for the remainder of the year. Coupled with strong organic growth, we expect modest margin rate accretion for the total year with a return to near 15% levels in the back half assuming a stable input cost and tariff environment. This is a simple function of price/cost timing as the year unfolds.

Moving to M&A. We also closed 2 strategic transactions in the quarter completing our acquisition of the Pengo and Paladin businesses from IES as well as our 20% equity investment in MTD, a large supplier of Craftsman outdoor power equipment as well as owner of the Cub Cadet and Troy-Bilt brands. With IES Attachments in combination with our Hydraulic Tools business, we now have a large portfolio of high-quality, performance-driven attachment solutions that will -- that creates a well-defined path for continued profitable growth. We expect IES to contribute approximately $300 million in revenue and be accretive to earnings in 2019. This asset has strong brands, deep customer relationships, and its independent dealer network has approximately 60% of its revenue related to aftermarket applications. Our focus is now on integration and achieving the cost and revenue synergies from the deal.

Our minority investment in MTD represents a strategic bet on long-term growth in the $20 billion Lawn & Garden market, structured in a financially prudent manner. The transaction includes an option for us to purchase the remaining 80% in 2021 and beyond, and we're excited to partner with MTD, a leading outdoor gas-powered equipment manufacturer with a great history and a great team.

And finally, based on our strong first quarter performance, we are raising our 2019 full year adjusted EPS guidance by $0.05 to a range of $8.50 to $8.70.

So in summary, 2019 is off to a good start, and our first quarter results provide us with good momentum and additional flexibility to execute and deliver the year. Leveraging our growth catalyst and SFS 2.0 operating system, we are continuing to lead into the external environment as the headwinds begin to dissipate. We remain focused on strong free cash flow generation and a return to operating margin expansion through productivity, cost control and pricing. And additionally, we are undertaking an extensive array of exciting new margin-focused initiatives to ensure rate expansion in 2019 and beyond. More to come on these initiatives at our Investor Day in a few weeks.

And with that, I'll hand it over to Don Allan for a more detailed discussion on first quarter results and 2019 guidance. Don?

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Thank you, Jim, and good morning, everyone. I will now take a deeper dive into our business segment results for the first quarter.

Tools & Storage revenue increased 3% as 7% organic growth was offset by 4 points of currency pressure. Organic growth included 5 points of volume and 2 points of price. We continue to see the benefits from the price actions we executed in the back half of 2018 as well as the additional price increases implemented this year in response to the List 3 tariffs.

The operating margin rate for this segment was 12.1%. Down from the prior year, the benefits of volume leverage, pricing and cost control were more than offset by the 2018 carryover impacts of currency, commodity inflation and tariffs. These carryover headwinds amounted to $160 million for Stanley Black & Decker in the first quarter, with much of this impacting the Tools & Storage segment. The strong organic growth and related share gains were experienced across each region and SBU.

So looking at the results on a geographic basis. North America once again led the way, up 11% driven by the U.S. retail channel, which posted high-teens growth. North America's growth continued to be fueled by the Craftsman brand rollout, new product innovations and price realization. We continue to see great momentum with the Craftsman rollout at our major retail partners and have seen a strong end-user reception as the product has hit the shelves. We couldn't be more pleased with the progress so far. More color to come on that as well as our Stanley and Stanley FatMax rollouts from Jeff later.

Europe delivered 3% organic in the quarter despite a continuation of slower market conditions across several countries within the region. The team continued to leverage our strong portfolio of brands, new product innovation and commercial actions to produce above-market growth.

And then finally, emerging markets delivered low single-digit growth driven by price, new products and e-commerce expansion. These actions were largely offset by continued market contractions in Argentina and Turkey, which presented an organic growth headwind of 3 points within the quarter.

We continued to see broad-based share gains across the region. Brazil, Ecuador and Mexico posted high-single to low double-digit growth while Russia, Korea, Taiwan and India all posted strong double-digit performances.

Now let's take a look at the Tools & Storage SBUs. Both had solid contributions to the overall performance. Power Tools & Equipment delivered 6% organic growth, which benefited from strong commercial execution and new product introductions. In particular, we had a solid contribution from new products launched under Craftsman, DEWALT and FLEXVOLT brands. Hand Tools, Accessories & Storage delivered 9% organic growth as new product introductions, the Craftsman rollout and, of course, contributions from the Lenox and Irwin revenue synergies all contributed to this growth.

So in summary, an outstanding quarter and a strong start to the year for the Tools & Storage organization as they continue to demonstrate above-market organic growth, tight cost control and strong price actions to overcome significant external headwinds related to commodities, currency and tariffs.

Let's turn to Industrial. This segment delivered 10% revenue growth, which included 16 points from the Nelson Fastener and IES Attachments acquisitions. A 3% organic decline and a negative 3 points from currency offset this significant growth from these acquisitions. Operating margin rate was down year-over-year to 13.9% as productivity gains and cost control actions were more than offset by the impacts from lower Engineered Fastening automotive volume, commodity inflation and the modestly dilutive impact from these acquisitions.

Engineered Fastening organic revenues were down 4% due to the declines in automotive light vehicle production and lower system shipments which were partially offset by continued fastener penetration gains. We continued to see declines in underlying global automotive production which impacts fastener volumes. However, it is also impacting the scope of automotive system projects that our customers are executing.

The Infrastructure businesses delivered 5% organic growth primarily driven by stronger North American onshore pipeline project activity in Oil & Gas. This was partially offset by lower hydraulic demolition tool volumes whose underlying market has been modestly impacted by the recent retraction in scrap steel pricing.

And finally, let's turn to Security. The Security segment revenue declined 1% with bolt-on acquisitions contributing 2 points and price delivering 1%, which was more than offset by unfavorable currency of 4 points. North America organic growth was up 2% as higher volumes in automatic doors and health care were partially offset by lower installation revenues in commercial electronic security.

Europe was down 1% organically. France was the bright spot for the quarter as the team was able to leverage new commercial actions in the small-to-medium enterprise market, which is associated with our transformation plan that Jim mentioned. However, this was more than offset by unfavorable market conditions in Sweden and the U.K., 2 larger markets for our Security European team.

In terms of profitability, the segment operating margin expanded 70 basis points to 10.3%. The Security team continues to demonstrate progress for this business transformation plan. They successfully executed on their first quarter objectives delivering margin rate and dollar expansion through cost control and a focus on minimizing recurring revenue attrition, so we achieved modest organic growth.

Additionally, the team continues to make investments in hiring and onboarding new commercial and field technician resources. We believe these actions, coupled with the new technology for customer solutions we have developed and are developing, will begin to translate into consistent growth as we move forward in the year. This is the third quarter in a row our Security team has achieved their financial expectations. Nice progress so far.

So now let's briefly look at the quarter's free cash flow performance on the next page. We were down approximately $65 million year-over-year mainly attributed to increased working capital. Tools & Storage continues to carry high levels of inventory to support the ongoing Craftsman rollout and other brand transitions that we are currently executing across the channels. As mentioned at January's earnings call, we believe the working capital levels will moderate throughout the year, and we will achieve working capital turns relatively flat to the prior year by the end of 2019. This will position us well for driving significant working capital improvement in 2020 so we can achieve approximately 100% free cash flow conversion in 2020.

So turning back to 2019. Please keep in mind that a free cash outflow in the first quarter is in line with normal seasonality. We remain confident that we will deliver strong cash flow generation for the year given our Core SFS processes and principles combined with reducing working capital levels in line with normal seasonal activity as I just discussed. Therefore, we are reiterating our commitment to deliver a free cash flow conversion rate of approximately 85% to 90% in 2019.

So now let's turn to 2019 earnings guidance. As Jim mentioned earlier, we are raising our adjusted EPS outlook for 2019 to range of $8.50 to $8.70, which is a $0.05 increase versus our prior guidance. On a GAAP basis, this results in a range of $7.50 to $7.70 per share.

Diving into a little bit more detail in our 2019 adjusted EPS. You can see on the left-hand side of the chart the increase is supported by the strong organic growth and cost control which drove approximately $0.15 of operational outperformance in the first quarter. This is partially offset by an incremental $20 million of currency headwinds, which primarily consists of adverse movements in the Brazilian real, Argentinian peso and Chinese RMB.

As it relates to recent acquisitions and divestiture activity, the impact from the acquisition of the Paladin and Pengo businesses from IES and the divestiture of Sargent and Greenleaf led to a relatively neutral impact to our full year 2019 EPS outlook. These IES assets will create solid EPS accretion in the later years through cost and revenue synergies.

One other item of note I would like to highlight is that we expect second quarter earnings per share to approximate 29.5% of the full year performance. This is generally consistent with prior year performance.

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 in 2019. We continue to execute on multiple catalysts, including the continued brand transitions with Craftsman, Stanley and Stanley FatMax; new product innovation, including FLEXVOLT; Lenox and Irwin revenue synergies; e-commerce and other emerging market opportunities. The margin rates are expected to be positive year-over-year, and the team will continue to leverage price, cost actions, margin initiatives and volume to offset the carryover headwinds we previously mentioned. We believe the business is well positioned for return to margin expansion in 2019 and anticipate a meaningful expansion in the second half.

In the Industrial segment, we expect organic revenue to be down modestly with total revenue growth positive from the contributions of our recent acquisitions. In Infrastructure, we expect Oil & Gas to be positive organically, and Hydraulic Tools to be relatively flat on an organic basis.

Engineered Fastening organic revenue is expected to be down modestly with growth in automotive and industrial fasteners being offset by a decline in the systems side of the business. We do believe the pressure we are experiencing in the automotive systems during Q1 will begin to subside in the later stages of 2019.

We expect operating margins to be down year-over-year driven by the modestly diluted impact from acquisitions and the impacts of negative product mix, specifically lower automotive system sales in Engineered Fastening.

And then finally, in our Security segment, we're expecting organic growth of low single digits and growth in operating margin dollars and rate year-over-year as the team continues to execute on its transformation strategy.

So in summary, the company's organic revenue will grow approximately 4%, and we expect 4% to 7% adjusted EPS expansion which is overcoming approximately $340 million of commodity, currency and tariff headwind, which is primarily related to carryover from 2018. We are encouraged by the collective performances across the portfolio in the first quarter, which gives us confidence to increase our 2019 EPS guidance range. We remain focused on leveraging the positive impacts from our continued strong organic growth, the previously executed pricing actions and the recently completed $250 million cost-reduction program to ensure we achieve our 2019 guidance. These factors, along with the beginning impacts of certain margin enhancement initiatives, will result in operating margin and rate expansion in 2019, and we expect meaningful expansion in the second half of the year.

With that, I'd like to turn the call over to Jeff to provide a few comments on the progress with the ongoing Craftsman, Stanley and Stanley FatMax brand transitions as well as some of the new innovations we are currently launching within the Tools business. Jeff?

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**Jeffery D. Ansell** - *Stanley Black & Decker, Inc. - Executive VP and President of Tools & Storage*

Thanks, Don. I'd like to share a few updates on our latest innovations and brand initiatives, including our recent launch of a new DEWALT 20 volt compact series called ATOMIC as well as the incredible progress of Craftsman.

Our Global Tools & Storage business had strong first quarter performance with high single-digit organic growth led by North America. A key component of this success was our continued focus on innovation-led growth. For example, our DEWALT FLEXVOLT platform was up double digits in the quarter as we continued to grow in the system of core products as well as expanding into the outdoor category with FLEXVOLT.

We're also pleased to announce the global launch of the 20-volt ATOMIC series, a range of tools that combines performance and durability in a compact format. The ATOMIC series augments our existing DEWALT 20-volt line, which is now the largest professional cordless system in the world with well over 200 products. With this global program just beginning to ship, we expect to see incremental growth in the pro power tools space within the year.

During our May Investor Day, we will detail this and other breakthrough innovations. Regarding Craftsman, the momentum and success from 2018 carried into 2019 with growth across all categories in Craftsman. Our Craftsman expansion plan remains on track, and we are well on our way to delivering our $1 billion target by 2021.

Now I'll turn it back over to Jim to wrap today's presentation.

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**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

Thanks, Jeff. And as you heard, it was a solid start to the year as we delivered above-market organic growth leveraging an array of growth catalysts. I'm proud of the team's efforts and execution, which have positioned us to achieve decent LTM financial results amidst a host of macro challenges. As these challenges anniversary, we are looking forward to a resumption of margin accretion in combination with our excellent growth.

And lastly, I want to remind everyone that we will be hosting an Investor Day on the morning of May 16 in New York City. This will be a great opportunity for us to communicate our strategic and financial objectives and discuss how we are pursuing growth, margin expansion and transformation at Stanley Black & Decker. As you can tell, we are passionate about delivering growth with margin expansion, and this will be prominently featured. We will also showcase members of our business unit and other key functional management teams, so please reach out to Dennis if you're interested in attending, and we look forward to seeing you there.

And we're now ready for Q&A. Dennis?

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

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

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from Jeffrey Sprague with Vertical Research.

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**Jeffrey Todd Sprague** - *Vertical Research Partners, LLC - Founder and Managing Partner*

Jim, I was wondering if you could address a little bit more -- as you've said in your opening monologue that the headwinds are dissipating, and I think we all kind of understand the comp issue and how it was front-loaded here in Q1. But can you provide a little bit more color on how you'd see that playing out in the back half? And I guess part and parcel to my question is it does look like we might be getting close to trade tariff resolution. And -- how do you think about maintaining price if we do get tariff relief?

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**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

Sure. Well, first of all, the massive hit that we took in the first quarter from the carryover headwinds goes down sequentially in the second quarter, but it's still over $100 million -- sorry, just below $100 million, right around $85 million. And then in the back half of the year, the price actually more or less offsets the remaining headwinds, the remaining carryover and whatever new modest headwinds that we have this year. So in general, that's just how the math works. And so we, as I said, assume a stable cost and tariff environment. If the tariffs go away, that's a pretty significant reduction in headwinds. I think the total amount of tariffs in for the year is just under $100 million or thereabouts. So most of the tariff impact is List 3. And from what we hear, the way the trade negotiations are going, that would be the most likely tariffs to be removed, List 3. And -- keeping in mind, to the last part of your question, that a lot of the pricing activity was not tariff related but also inflation related. And so I think that when you finally add it all up, I mean, the price recovery against the tariffs only amounted to about 40 -- between 40% and 50%. And so there was a big chunk of inflation-related cost that was not covered by the price as well as some of the tariffs. So I think that -- we'll see how that all plays out, but I think there's sufficient inflation and headwinds to justify a fairly stable price environment going forward.

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Okay, let me just clarify that the number that Jim gave in 2Q was net of price. Just want to make sure that, that's not -- people understand that's not gross headwinds. And the other thing to keep in mind is if you did -- if all the tariffs went away, we've communicated this previously, the impact net of price would -- on an annualized basis would probably be somewhere around $40 million to $50 million. And that's all tariffs. And if List 3 happens, it's probably 1/3 to 50% of that number.

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**Operator**

Our next question comes from Josh Pokrzywinski with Morgan Stanley.

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**Joshua Charles Pokrzywinski** - *Morgan Stanley, Research Division - Equity Analyst*

I guess just a follow-up on Jeff's question there with the margin expansion that you guys talked about in tools. I think, Don, you mentioned a few times strong margin expansion in second half. Should we still expect to see something in 2Q? And how has that changed just given maybe some of the timing of headwinds or price increases or the competitive dynamic out there with respect to price?

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes, we were saying over the last couple of months we were anticipating a kind of modest improvement in margin rate in the second quarter, and we still believe that will be the case. And as we get into the third and the fourth quarter, both Jim and I indicated we expect the incremental accretion rate for tools to become quite meaningful, and that's still the expectation at this stage.

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**Operator**

Our next question comes from Michael Rehaut with JPMorgan.

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**Michael Jason Rehaut** - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Congrats on the quarter. The question I have is -- relates to the Tools & Storage performance. Obviously, continued great execution on the top line. Given some of the new initiatives that you launched or that Jeff referred to, I was hoping to get a sense of when you think about the mid-single-digit growth for this segment for 2019, if you could kind of break that down by looking at also the -- break it down by some of the growth initiatives' contribution such as Craftsman, such as FLEXVOLT as opposed to the core market growth and if that's changed at all particularly given the first quarter performance.

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes. As we've indicated previously, we think Craftsman is about 3 points of growth for the full year. The first quarter was fairly representative of that. And we don't see any different view at this stage. We've indicated mid-single digits. We've also said that, that probably means we're -- and our view is we're floating around 6%, possibly 7%. And we still feel like that's the right estimate at this stage. What we don't know is just how impactful Craftsman is going to be. It's been very positive, and if those trends continue, those numbers could be a little bit better as the year goes on. But I look at the core underlying markets, they're performing well. The -- we had some weak markets in Europe, as we talked about, where we don't have a lot of market growth right now in many of the countries. But we are demonstrating growth as we had 3% organic growth in the first quarter. So we're outpacing there. And that really has more to do with just strong commercial activities, product innovation, et cetera, like the European team has done for several years now. In North America, you saw the magnitude of the growth of double digits and the impact of Craftsman being in there, but even if you exclude that impact, it's still pretty significant performance, which will include things like FLEXVOLT and other matters as well. So we still feel like that's a reasonable estimate at this stage. We all have to keep in mind that it is the first quarter. As we get to the second quarter and we complete the rollout of Craftsman in Lowe's through all the different stores, we'll have a good sense of where we are and read in the back half of the year and what that means. But I think at this stage, we feel good about an organic growth number about 6% to 7% for tools.

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**Operator**

Our next question comes from Tim Wojs with Baird.

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**Timothy Ronald Wojs** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Good start to the year. I guess just maybe on -- back on tools on growth in the quarter. Relative to your expectations a couple of months ago, where do you think you saw the outperformance internally? Was it better sell-through at retail? Was it the types of products that consumers are buying? Just a little bit more color on maybe what was better relative to your expectations in the quarter.

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**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

I guess kind of all of the above. The sell-through has been fantastic, and the product introductions have been really well received. And so it's a combination of all those factors. And I think also the market is more stable than I think we were thinking a quarter ago. Although there is some choppiness in housing and so on, I think in general it's more stable than we would have expected at this point in time. And the interest rate reductions have helped a lot.

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**Operator**

Our next question comes from a Julian Mitchell with Barclays.

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**Julian C.H. Mitchell** - *Barclays Bank PLC, Research Division - Research Analyst*

You've given us some very good color on your updated sort of macro thoughts around North America demand. I just wondered if you could give us an update around expectations for organic growth firm-wide in Europe and the emerging markets where it was sort of flattish both in Q1? Just wondered how you think the rest of the year will play out for Europe and EM?

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes, I think what we experienced in Q1 is not going to be dramatically different other than I would say probably emerging markets might demonstrate more growth as we get to the back half. They clearly are dealing with some difficult circumstances in 2 countries that I mentioned of Turkey and Argentina. But we do start to kind of lap that in the middle of the year. And so the comp gets a little easier from that perspective to demonstrate organic growth. So I think we'll see a little bit of an improvement in the organic growth profile in the back half for emerging markets. But I think Europe will continue to be kind of a low single-digit growth performance for a good part of the year. And North America will continue to be strong.

**Operator**

Our next question comes from Nigel Coe with Wolfe Research.

**Nigel Edward Coe** - *Wolfe Research, LLC - MD & Senior Research Analyst*

I'm sure you're glad to get one Q behind you. So obviously great news on SG&A, big reduction there. I'm assuming that's where the bulk of the cost action is coming through in that line. I know you're going to address this more on the upcoming May conference, but maybe can you talk about the margin transformation initiatives on the way? And is that more of a capacity and gross margin initiative? I mean how does that differ from the -- some of the regular way you're structuring the company going?

**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

Sure. So the margin resiliency initiative, we'd like to call it, gets us back to kind of our historical margin accretion about 50 basis points a year after we get back to our prior levels, which we will accomplish pretty much this year and start to have margin accretion again. And so this -- really, the intent of this is it may have a modest '19 impact, but the real impact will be 2021, and we'll be driving that 50 basis point and possibly even more margin accretion going forward. And the -- we'll get into a fair amount of detail about this on May 16. But the general thrust is utilizing technology and technological advancements to enhance value-creation initiatives that already exist. So it could be as it relates to price, it could be as it relates to procurement and so on. So there's different categories or buckets, if you will, where we're taking technology and utilizing kind of leading-edge practices to data analytics, artificial intelligence, cobotics, those types of things to actually enhance our margin and create value. That's the basic idea.

**Operator**

Our next question comes from Nicole DeBlase with Deutsche Bank.

**Nicole Sheree DeBlase** - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

So I just want to dig into 2Q a little bit. It seems like that's the thing that the investors are asking about most or grappling with since -- I mean it seems like it's not a whole lot different than normal seasonality for me, but essentially, consensus is doubling versus 1Q, excluding the tax benefits. So have you guys kind of talked through the big puts and takes? I know we talked about the $85 million headwind. What's the gross headwind expected? If you could talk through organic growth since I think the comp gets a bit tougher year-on-year. Tax rate and anything else that we need to consider when we're thinking about bridging from 1Q to 2Q.

**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes. I mean, clearly, the volume overall is the biggest driver where the volume of the whole company will probably be up $400 million to $450 million sequentially from Q1 to Q2. So that's clearly a big driver. You also have the growth headwinds go down on an absolute basis by about $30 million to $35 million from Q1 to Q2 while the price benefit stays relatively consistent. So you get a benefit there as well. And then some of our cost actions were not completed until Q1, so you get a full quarter benefit of that in Q2. Those are really the 3 main drivers that are driving that. There's a little bit of a modest impact from a lower tax rate in Q2 versus Q1 as well as many of the tax benefits we're expecting in the first half versus the back half of the year. Those are the main -- those are the 4 main drivers that would get you to that number.

**Operator**

Our next question comes from Joe Ritchie with Goldman Sachs.

**Joseph Alfred Ritchie** - *Goldman Sachs Group Inc., Research Division - VP & Lead Multi-Industry Analyst*

Maybe just touching on the focus at the Analyst Day. I know we're going to talk a lot about the margin expansion. But maybe just a broader question around, like is this a pivot? You guys have been focused very much so on the growth initiatives historically the $22 billion by '22. And now it seems like this Analyst Day is going to be a little bit more focused on the margin expansion opportunities. And so maybe discuss a little bit just kind of the shift in philosophy there.

**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

It's not really a huge shift in philosophy. It's really kind of back to the future. We've always -- in the last, I'd say, 5 to 7 years, we have always been focused on growth and margin expansion. And if you go back and look at the years preceding last year, there's a pretty strong track record of strong organic growth, acquisitive growth plus margin expansion. And that formula has been very lucrative for the -- for shareholders and we intend to get back to that. So the reason we, obviously, got off that track through 1 year is -- has everything to do with the headwinds that we've talked about ad nauseam. So this is something that we are fixated on doing in this company is doing both. And I know a lot of companies it's either or, but we don't think of it that way. And we have the capability and the track record to expand margins while growing, and we intend to get back to that in the beginning in 2019 but really in earnest in '20 and '21.

**Operator**

Our next question comes from Deepa Raghavan with Wells Fargo.

**Deepa Bhargavi Narasimhapuram Raghavan** - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Good quarter there, Jim and Don. Your outlooks for Q2, just a little bit touching on that given that it's an outdoor season, heavy season. I mean outlooks looks it's like 250-ish at midpoint. Can you talk about momentum into Q2, including possibly any point-of-sales stats in North America? And what are some of the upside and downside case in Q2? We know it's an outdoor season. It's meaningful to Craftsman/MTD just the weather in there, but -- I mean year-on-year basis or anything else that -- other than what you've addressed earlier, that will be helpful.

**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes. So I'll pass over to Jeff in a minute to maybe give us some commentary on the outdoor season view for us. But as I mentioned and Jim mentioned, the POS is strong in the first quarter. We do think that trend will continue into the second quarter and likely for the remainder of the year. The other drivers are the reason for why we think that business will continue to improve around margin rate in the second quarter, so we can achieve what I described. But let me give Jeff a chance to give a little more color on our view of the outdoor season.

**Jeffery D. Ansell** - *Stanley Black & Decker, Inc. - Executive VP and President of Tools & Storage*

So to reiterate what Don just said, POS was robust as were the organic growth numbers in North America in Q1. It's not a great deal of outdoor activity in that quarter. It more of starts in the second quarter versus the third. But what we did see was a slow start to the outdoor season as much of the U.S. market was underwater, if you remember early days start of spring. That changed quite significantly in the last 4 weeks. So a season that started out negative has turned positive at this point, certainly from -- for us. And we're comping relatively sluggish outdoor numbers from last year. If you remember last year's outdoor season wasn't a really robust one. So it's been really positive for the last 4 weeks and we have every reason to believe it will continue to be positive through the second quarter: one, given the kind of sluggish comps from last year, but also the new product development that we put into the market this year in the DEWALT brand as well as the Black & Decker brand and most recently the Craftsman brand. So quite positive.

**Operator**

Our next question comes from Rob Wertheimer with Melius Research.

**Robert Cameron Wertheimer** - *Melius Research LLC - Founding Partner, Director of Research & Research Analyst of Global Machinery*

I just wondered if you could give any kind of an update on Craftsman production, U.S. production, just progress? And then any thoughts on evolutions at MTD and if you are able to achieve better results through aiding them?

**Jeffery D. Ansell** - *Stanley Black & Decker, Inc. - Executive VP and President of Tools & Storage*

I'll start with the first part of question and turn it over to Jim for the second part. Craftsman domestic manufacturing is in a really good place, where we essentially began the process with almost no domestic manufacturing for Craftsman and what we procured. To this point over the course of about 12 months, we've gone from what was almost 0% to about 1/3 of the product line manufactured domestically today on our plan to double that going forward, which we'll give you more detail around that at the May Investor Day. But the inertia created by Craftsman and then combining that with domestic manufacturing, the combination of those 2 things, has lead us to growth in every category that is Craftsman today. So we're quite pleased with where we are, but I would say we have yet a lot to do.

**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

Great. So on MTD, really excited about the transaction, including the option, but as excited about the people that we get to work with because, frankly, the transaction has got us all set up with the confluence of interest in a sense that any EBITDA growth that occurs, we'll kind of share the benefits post closing of the 20%. We'll share the benefits 50-50 in terms of the ultimate determination of the option price. And that structure has put us in a position where we are working together in earnest on value-creation opportunities for MTD that include everything from growth to cost reduction to margin expansion and so on. And it's going to be a multiyear program. And as we're running it like an acquisition integration while subscribing to all the principles of antitrust that we have to subscribe to. And we're very confident that we will get MTD's profitability up to a point where it will be able to slide it into our portfolio in 2021 or 2022 in a way that is really accretive for us and is a great deal for the folks at MTD.

**Operator**

Our next question comes from Justin Speer with Zelman & Associates.

**Justin A. Speer** - *Zelman & Associates LLC - MD of Research*

I just wanted to further unpack the Tools & Storage growth and what you're looking for underlying market growth for this business and how that kind of sequences as the year progresses. And then dovetailing that question with, is the reality that if we do get trade resolution, do you think you'll be able to hold onto most of that price? Do you think you'll be able to hold onto the potential savings from tariffs going away?

**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes. As I mentioned on growth earlier for Tools & Storage, we have a view of 6% to 7% for the full year. We expect Craftsman to be about 3 points of that, which would demonstrate some modest growth over GDP if you look at it globally, modest being 1 point to 1.5 points, so that's pretty significant in some camps around the world. But that's our view, and we think that will continue to be the case. And we're very hopeful that Craftsman outperforms expectations. And maybe some other product innovations and other growth catalysts to do as well, and we'll see as the year progresses. We've talked about how we have a lot of work to do on Craftsman to complete the rollout in the second quarter. And then we have to focus on the rollout of other brands and some of our other customers. So we have a lot of work to do over the year to make this happen, but we're positive at this stage, and we'll continue to provide updates along the way, in particular in July and October.

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**Operator**

Our next question comes from Robert Barry with The Buckingham Research.

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**Robert Douglas Barry** - *The Buckingham Research Group Incorporated - Research Analyst*

Congrats on a solid start. I just wanted to actually clarify a couple of things. One is just why the Industrial outlook is weaker? And that how much of that weakness happened in 1Q? And then just on a couple of P&L items that price and commodities are still kind of plus 150, minus 150. And if there's any kind of potential upside or downside to those values just based on what we're seeing with commodities?

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes. I think for Industrial, our view is a little bit worse than it was in January. As we saw the automotive -- light vehicle production was down almost 5% in the first quarter, which was worse than projections. It's supposed to be down a little bit smaller number in the second quarter and then begin to moderate in the back half of the year. We do think systems will start to return in the back half of the year. That's the feedback we're getting from a lot of our key customers. And so that's clearly a pressure point although it's a modest pressure point versus expectations. I think we were thinking relatively flat back in January. Now we're just down modestly as a result of that. I mean I think the Engineered Fastening team is doing a great job managing through this cycle with the auto industry and looking for opportunities and some of the -- and the Nelson acquisition that they've done as well as the other aspects of the Industrial fastener business within their world, so they continue to be focused on that.

The headwinds, as we mentioned, are -- have gone up a little bit overall, $20 million due to FX. And at this stage, commodities are not changing dramatically, although we think as we go through the year, that could be an opportunity that we see emerge as the year goes on. But right now, it's not flowing through as an opportunity for us to capture in our P&L at this stage.

And then tariffs are a bit of an open wildcard at the stage as to what happens? Do we have a deal with China in the future? And if we do, do all the tariffs go away? Or as Jim said, do they partially go away? It's a factor that we see. But we feel good about where we're positioned as a company to deal with these headwinds even though we saw modest increase in them. It feels like as we go throughout the year, the ones in commodities and tariffs feel like there is a possibility for an opportunity to get smaller. However, we could potentially see a little bit more pressure in currency as we go throughout the year. We certainly saw the volatility of that last year, but I think that currency tends to be something that's easier for us to manage if that's the only major headwind we're dealing with.

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**Operator**

Our next question comes from Michael Wood with Nomura Instinet.

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**Michael Robert Wood** - *Nomura Securities Co. Ltd., Research Division - Research Analyst*

I was hoping you could provide some color in terms of -- you gave a very explicit 1Q guidance which you beat operationally, you said, by about $0.25 -- sorry, $0.15 or so excluding that -- the timing of the tax. Curious if there was some other pull-forward in 1Q that didn't allow you to flow that $0.15 beat into your 2019 guidance?

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

As I mentioned in my commentary is that, yes, we did have an operational outperformance of $0.15 in the first quarter. So we did see $20 million increase in currency or $0.10 of an impact related to that. So the net benefit of those 2 is about $0.05. And we felt at this stage the prudent thing to do is to let that flow through and see if we get resolution on China trade. Let's see if some of the trends that I mentioned emerge in the volume of tools as well as the headwinds associated with commodity and tariffs. And so it's a prudent first step, and we'll see how things progress in the next quarter.

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**Operator**

Our next question comes from David McGregor with Longbow Research.

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**David Sutherland MacGregor** - *Longbow Research LLC - CEO and Senior Analyst*

Congratulations on a good quarter. Just on Craftsman, thinking about second quarter and the dynamics around the Craftsman brand. Can you update us on the timing of the load-in? I think you mentioned earlier that Lowe's you expected that to be complete in the second quarter, but have you started the Amazon load-in yet? And if so, how far into that process are you? And finally, can you update us on the timing of the load-in Home Depot on the Stanley and FatMax and how long that'll take to complete?

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**Jeffery D. Ansell** - *Stanley Black & Decker, Inc. - Executive VP and President of Tools & Storage*

Yes. It is Jeff. I'll take the question. The -- I'll give you the status first of Stanley, Stanley FatMax and then we'll migrate to Craftsman. We've just begun the process of rolling out the Stanley and Stanley FatMax products that we highlighted last earnings call, so they are just flowing through the supply chain into stores. You will see those products set -- the first phase of that set this coming month. So in the month of May, you'll see those things set at store level. So no underlying POS or any of that at this point, but the rollout is going quite well, so we're very positive on that.

Regarding Craftsman, probably similarly, we had greater demand for the product than we anticipated, and as such, we've expanded our view of the size of Craftsman and the timing of Craftsman previously in order to make certain that we can accommodate that increased demand via supply. We have elected to move the rollout of new customers on Craftsman to the early parts of the second half of this year. So in an attempt to make sure we can satisfy the customers that we do have today and the demand that the end user has created, we pushed those back just a bit, but they will begin early second half. And we'll roll those things out in the cadence we described but starting at that point in time. So all positive underlying reasons to do those things. And again, we're quite positive with both the rollout of Stanley, Stanley FatMax and Craftsman across all categories.

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**Operator**

Our next question comes from Ken Zener with KeyBanc.

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**Kenneth Robinson Zener** - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Jeff, can you talk to the outdoor category given MTD and Craftsman, specifically from a bigger picture about what constrains the expansion of cordless applications into gas? I mean is it your guys internal R&D? Is it just the market price? Or you don't want to be the bleeding edge?

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**Jeffery D. Ansell** - *Stanley Black & Decker, Inc. - Executive VP and President of Tools & Storage*

Well, it has advanced quite significantly in the last, I'd say, 2 years, right? So it's -- there've been cordless -- nongas cordless outdoor products for -- from us for almost 3 decades. But the cost curve has enabled us to be us and others to get electric product competitively priced with petrol, really for the first time in the last 12 months. And at that point, then the consumer has a decision to make. They would either choose petrol which they're accustomed to today or migrate to electric, and that's a process that's beginning as we speak. So I'd say that technology enables that today. So you see this in categories like string trimmers, hedge trimmers, blowers, chainsaws, things that have historically been gas driven. And that migration has happened relatively rapidly. And you'll see -- if you survey retail today, you'll see examples under the Craftsman brand where we have endcap registration that says, you choose your power source, so it will be gas product or the electric equivalent at the same price, allowing your user to make the decision, which has been the first time in history we have ever been able to make that claim or do that and it is going really well. So I don't think there is any technological hurdles with it in that sense. As you get into higher and higher-output products, walk-behinds, ride-on mowers, that's still -- there's still a gap between the value proposition of petrol or gas and electric. And we and others are working to close that gap, but there's probably a little more work to be done there. But the early read is very positive in electrification of outdoor products being led really by us across brands like Black & Decker, DEWALT and Craftsman.

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**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

One of the things that we're doing to take advantage of this period where we own 20% of MTD and have not yet exercised the option is to collaborate on R&D because it's an application challenge. It's not just a battery challenge. It's a system challenge. So their expertise in the actual units of outdoor power equipment as we go up the power curve and our expertise in battery technology and application to lower power output type products, it's a great combination, best combination in the industry to tackle this, and we're going to be out in front on that one.

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**Operator**

Our next question comes from Susan Maklari with Crédit Suisse.

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**Susan Marie Maklari** - *Crédit Suisse AG, Research Division - Research Analyst*

I wanted to focus a little bit on the cash flows and the balance sheet. On the last call, you talked to taking a defensive approach to cash flows this year with a focus on deleveraging. And with the operating environment coming in a bit more stable relative to your initial expectations, are there any changes to your capital allocation plans for this year?

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

There really isn't any significant changes to our capital allocation strategy. As we've thought about January, we're preparing the company for a slow growth environment. And we were concerned about housing in particular, what was happening as interest rates were -- had been rising in the previous year and there was talk about continued increases in the area and what that could mean for housing. As Jim mentioned, that's changed a lot in the last 3 months, where now the Fed has a different kind of position on interest rates and have actually -- we're seeing a little bit of a reversal in that trend, and that's had a bit of a positive impact on housing.

But we're still dealing with a relatively -- a little bit of a slow growth environment in certain pockets. We have a slow automotive industry. Housing is doing okay, but it's not robust at this stage. And so we're not overly concerned about the economy at this view. We feel good about how we've set up the company to be prepared for, as we mentioned, various different environments and this was one of them. And the importance of our capital allocation is we have to keep in mind that in the previous couple of years, we have done some significant capital allocation transactions, including buying back stock, acquisitions of IES, MTD, Nelson Fasteners, and then before that, we had Craftsman and we had the Newell Tools acquisition. So we've allocated a fair amount of capital to these different areas. So a couple of things are happening this year: one, we want to get our debt-to-EBITDA ratio down closer to 2x, and we will achieve that with the current cash flow view and projection of the business. And that will really position us to be able to look at other allocation strategies in the M&A world as we go into 2020. And frankly, we need to absorb a lot of those transactions that we've completed in that time frame as well.

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**James M. Loree** - *Stanley Black & Decker, Inc. - President, CEO & Director*

I think there is a massive amount of execution going on as you can glean from the conversations that we've had in the last hour, and it's all going really well. But as Don said, we kind of want to get our debt to EBITDA down to right around 2 and digest just some of these things and exploit some of the growth opportunities that we have. And then we'll look in -- as we go into 2020 and beyond, does more repurchase make sense or do we have some acquisition opportunities that might be very attractive to help us continue to drive growth.

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**Operator**

Our last question comes from Justin Bergner with G. Research.

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**Justin Laurence Bergner** - *G. Research, LLC - VP*

You made a comment earlier on the call that you're hoping to reach 100% or close to 100% free cash flow conversion in 2020. I'm not sure, but it seems like that's a pull-forward of your earlier comment that, that was more of a midterm goal. Could you clarify that, that's the case and sort of maybe indicate what drivers will allow you to get that free cash flow conversion up to 100% in 2020?

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**Donald Allan** - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes, I think one of the things that we've talked about in the last year or so is that we've had to really take some pressure on in our working capital as we deal -- dealt with the brand transitions, which are fantastic opportunities for us to develop organic growth and you've seen that track record in the Tools & Storage business. And therefore, we haven't seen significant progress in working capital terms. In the last -- previous year as well as this year, we'll probably a little bit flat year-over-year. So as we go into 2020, we see opportunity once those transitions have kind of gotten to a more stable state on a go-forward basis and they're really embedded in our existing business and then we're dealing more with just new product introductions and new innovations, et cetera. That gives us an opportunity for us to make some significant improvement in working capital terms. We'll end this year probably somewhere between 8.5 and 8.8 for working capital turns of the company. And therefore, we've been over 10. And so there's no reason why we can't see that opportunity going into 2020 and 2021, which means that significant benefits will flow through free cash flow, which will allow our conversion to get back up to 100%.

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**Operator**

Thank you. This concludes the question-and-answer session. I would now like to turn the conference back over to Dennis Lange for closing remarks.

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

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

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**Operator**

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

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