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## SWK - Q2 2019 Stanley Black & Decker Inc Earnings Call

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**OVERVIEW:**

Co. reported 2Q19 revenues of $3.8b. Expects 2019 GAAP EPS to be $7.50-7.70 and adjusted EPS to be $8.50-8.70.

## CORPORATE PARTICIPANTS

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## PRESENTATION

**Operator**

Welcome to the Second 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 Second 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 second quarter 2019 results and various other matters followed by a Q&A session. (Operator Instructions)

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 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.

It's my understanding that the webcast may have some issues with the advancing of slides. And so as such, we will be identifying which slide we're speaking to as we move through the presentation today.

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*

Thanks, Dennis, and good morning to our guests. Thank you for joining us.

Stanley Black & Decker delivered a strong outperformance in the second quarter to close out the first half of 2019 in a solid position. We continued to generate above-market organic growth, achieved operating margin rate expansion and delivered adjusted EPS growth, overcoming $110 million of pretax currency, commodity and tariff headwinds.

This 2Q outperformance is a testament to the agility and determination of our 61,000 employees around the globe. Their continued efforts to drive growth, realize price and control costs enabled us to successfully overcome the external forces that have pressured our margins in recent quarters. With their help, the company produced its first quarter of operating margin rate accretion since the fourth quarter 2017, a critical milestone.

On that positive note, second quarter revenues were $3.8 billion, up 3% versus prior year. This included 3% organic growth and 3% from acquisitions, which was partially offset by a 3-point currency headwind. Price materialized as expected, contributing 2 points of revenue growth in the quarter. The growth was achieved despite some challenges in specific markets this quarter such as continued declines in global automotive light vehicle production and a deceleration in other industrial-focused end markets. Emerging market conditions were also generally weaker than normal in several markets around the world.

Tools & Storage achieved a strong 5% organic growth rate with most regions and business units contributing. The tools business continues to benefit from a powerful set of catalysts, including the ongoing Craftsman rollout. We also benefited from continued focus on product innovation and commercial execution, and as a result, the team continued to build on its record of consistently delivering market share gains.

Industrial total revenues grew 13%, enabled by the IES Attachments acquisition. In its first full quarter of results, the business is demonstrating pro forma organic growth with solid operating margins, and the financial performance remains on track. Assimilation of employees, suppliers and customers is well underway and going smoothly, and all in all, we are pleased with how the integration is progressing.

Security continues to demonstrate progress on its value-creation plan with improvements in both operating margin dollar and rate versus prior year. The margin improvements delivered to date are encouraging, and we believe there's more to come. We're now seeking to leverage our talent investments and our commercial initiatives to generate organic growth. The recent infusion of over 1,000 digitally proficient associates has upgraded the Security talent base and enabled the rapid commercialization of technology-centered customer solutions. We expect to see continued progress on all fronts in the coming quarters for Security, and as you could appreciate there is significant value-creation potential associated with a successful transformation.

Moving to the overall company. I'm pleased with our strong operational performance, which was punctuated by 60 basis points of operating margin rate expansion and 4% adjusted EPS growth versus prior year. This was achieved with a laser focus on cost control and price execution with our business teams overcoming in the quarter approximately $110 million of mostly 2018 carryover headwinds.

With a solid first half behind us, we are reiterating our full year adjusted EPS range of $8.50 to $8.70. This includes 4% organic growth, margin rate expansion and 4% to 7% adjusted EPS growth versus prior year while absorbing an estimated $390 million in combined tariff, currency, cost inflation, OM pressures, again mostly from 2018 carryover.

The power of our growth catalyst is clear. We continue to deliver above-market organic growth even if some markets around the world have slowed. These share gains have resulted from execution of our SFS 2.0 operating system and include an array of programs, including the Craftsman brand rollout, breakthrough innovations such as DEWALT FLEXVOLT, ATOMIC and Xtreme as well as from acquisition revenue synergies, emerging markets and e-commerce.

To ensure that we create an even more resilient, adaptable and agile organization, we recently launched a major company-wide program that we call margin resiliency. As mentioned in our May Investor Day, this program will deliver $300 million to $500 million of annualized operating margin benefit over a multiyear period. The effort is centered around creating benefits across our entire value chain by applying the latest digital technologies and techniques such as artificial intelligence, advanced analytics and others to optimize performance and create incremental margin. Specific areas of benefit include supply chain automation and optimization, including Industry 4.0, price realization, indirect cost reduction and organizational efficiency.

Our ability to execute a program of this nature as forward facing and impactful as it is was made possible by our aggressive investments in recent years in digital transformation. Our purposeful commitment to high performance, innovation and social responsibility has enabled us to attract and inspire the talent capable of doing this. Margin resiliency will have impact as early as the second half 2019, and the momentum will build in 2020 and beyond.

And finally as a separate but also positive note, I'd like to highlight that last week, we increased our dividend for the 52nd consecutive year. The quarterly payout now stands at $0.69 per share, which represents a 5% increase. This is a reflection of our confidence in our cash-generation capability and our capital allocation strategy of returning approximately 50% of our excess capital to shareholders through dividends and repurchases and 50% towards M&A over the long term.

And with that, I'll now hand it over to Don Allan for a more detailed discussion on second 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 second quarter.

For those following, I'm on Slide 5 within the presentation. Tools & Storage revenue was up 2% as 5% organic growth was offset by 3 points of currency pressure. Volume growth contributed 3 points while price was aligned with our expectation and added another 2 points of growth.

The tools team continues to do an excellent job balancing price realization and margin recovery with above-market organic growth and share gains. The operating margin rate for this segment was 17%, expanding 80 basis points from the prior year as the benefits of volume leverage, pricing and cost control more than offset the impact of currency, commodity inflation and tariff. Returning to margin expansion was an important milestone within tools, and it was realized in the second quarter while offsetting significant external headwinds.

As Jim mentioned, the company had $110 million of tariff, commodity and currency headwinds to more than offset in the quarter. The Tools & Storage business was impacted by greater than 90% of these headwinds. The strong organic growth and related share gains were experienced across most Tools & Storage regions and SBUs.

Looking at it on a geographic basis. North America led the way and was up 7% organically. This performance was driven by share gains in our U.S. retail and commercial channels, up high single digits and mid-single digits, respectively. This was partially offset by a modest decline in the industrial-focused business.

The overall North American results were robust considering that we saw some of our construction and industrial-focused customers modestly paring inventory during the quarter. North America's growth was fueled by the Craftsman brand rollout, price realization and new product innovations. Clearly, these growth catalysts are resonating with the end user and delivering share gains as evidenced by double-digit POS experienced in the second quarter.

Moving on to Europe. Europe delivered 5% organic growth. 8 out of 10 markets grew organically with double-digit performances in Central Europe and Iberia and solid mid-single-digit performances in Germany, the U.K. and the Nordics. The team continues to gain share, leveraging our strong portfolio of brands, new product innovation and commercial actions to produce above-market growth.

And then finally, emerging markets. Emerging markets declined 2%. The ongoing benefits from price, new products and e-commerce expansion were more than offset by a 3-point impact from market contractions in Argentina, Mexico and Turkey. Despite the pressures from these 3 markets, we continue to see broad-based share gains across the region. Brazil, Colombia and Taiwan posted mid- to high single-digit growth while Russia, Korea and India all posted robust double-digit performances. The emerging markets team is focused on delivering pricing benefits to recover currency headwinds and leveraging our growth catalyst to deliver share gains in what we expect to be a continued slower-growth market environment in the back half of the year.

Now looking at the Tools & Storage SBUs. Both lines had a solid contribution to the overall performance. Power Tools & Equipment delivered 6% organic growth, benefiting from strong commercial execution and new product introductions. In particular, the outdoor segment posted high-teens growth driven by new products and expanded merchandising launched under Craftsman, DEWALT and DEWALT FLEXVOLT brand. Jeff will provide more detail about this later in the call. Additionally, we will begin shipping our newest -- we began shipping our newest breakthrough innovations, Atomic and Xtreme, which have a superior power-to-weight ratio compared to other products currently on the market.

Hand Tools, Accessories & Storage delivered 4% organic growth as new product introductions and the ongoing Craftsman rollout continued to contribute to growth. So in summary, another excellent quarter for the Tools & Storage organization as they continue to leverage our growth catalysts to deliver above-market organic growth and share gain. Equally as important, they returned to margin expansion, overcoming significant external headwinds through growth, cost control and disciplined price execution.

Now turning to Industrial. This segment delivered 13% revenue growth, which included 18 points from the IES Attachments acquisition, which was partially offset by a 3% organic decline and a negative 2 points from currency. Operating margin rate was down modestly year-over-year to 16.4% as productivity gains and cost control were more than offset by the impact from lower Engineered Fastening volume and commodity inflation.

Engineered Fastening organic revenues were down 4% due to declines in automotive light vehicle production, lower system shipments and softer general industrial end markets, which were partially offset by fastener penetration gains. We continued to see declines in underlying global automotive production for the fourth consecutive quarter, which has been down approximately 5% during the first half of 2019.

The Infrastructure business has delivered 2% organic growth primarily driven by stronger onshore pipeline project and inspection activity in oil and gas. The growth was partially offset by lower hydraulic demolition tool volumes whose underlying market is negatively impacted when scrap steel pricing declines.

And then finally, the Security segment declined 3%, with bolt-on acquisitions contributing a positive 2 points and price delivering a positive 1 point. This was more than offset by volume being down 2%, unfavorable currency of 3 points and then a negative 1-point impact from the Sargent & Greenleaf divestiture.

North America Security was flat as higher volumes within health care were offset by lower automatic door installations. The strong order and backlog trends in this region continue to demonstrate growth is around the corner.

Europe was down 2% organically. France was again a bright spot for the region as the team leverages commercial actions in the small to medium enterprise market that is associated with our overall transformation plan. This growth, however, was more than offset by adverse market conditions in Sweden and the U.K.

In terms of profitability, the segment operating margin expanded a significant 120 basis points in the quarter to 11.2%. Once again, the Security team demonstrated progress with its business transformation. For the third consecutive quarter, they successfully delivered margin rate and dollar expansion through controlling costs and delivering operational efficiency in our service and monitoring organizations.

To take the next steps, Security needs to demonstrate consistent organic growth in the back half of 2019. We are encouraged by the value-creation potential from our commercial investments. Year-to-date, we have filled over 100 new sales positions and added over 40 technicians in the United States and Europe. We are bringing in digitally enabled skill sets to develop new solutions that utilize the information flowing through our analytics platform to deliver insights to help our customers improve their operational efficiency. We have also begun commercializing new app-based solutions for our small- to medium-sized customers. While this has not yet manifested itself into significant organic growth, we have seen strong order patterns and backlog improvements, which make us optimistic that growth is on the horizon.

Now let's move to Slide 6 and briefly look at the quarter's free cash flow performance on the next page. For the second quarter, free cash flow was $404 million, which brings our year-to-date performance to use of cash of $117 million. The quarterly and year-to-date improvements versus the prior year are predominantly explained by higher net income, lower CapEx and a significant improvement in working capital. We remain confident that we will deliver strong cash flow generation for the year, utilizing our Core SFS processes and principles, combined with reducing working capital levels in line with normal seasonality activity. Therefore, we are reiterating our commitment to deliver a free cash flow conversion rate of approximately 85% to 90%.

Now let's turn to earnings guidance on the next page, Slide 7. We are reiterating our 2019 adjusted earnings per share guidance, which calls for approximately 4% organic growth and an adjusted earnings per share range of $8.50 up to $8.70, up approximately 6% at the midpoint. On a GAAP basis, the EPS remain -- range remains unchanged at $7.50 to $7.70 per share.

Now diving into a little more detail on our 2019 adjusted EPS outlook. You can see on the left-hand side of the chart we estimate an incremental $50 million in external headwinds primarily related to List 3 China tariffs, which is in essence increasing from 10% to 25%. This increase will be partially offset by slightly lower second half expectation related to commodity inflation.

Additionally, we are modestly adjusting our full year expectations around organic volume growth, which reflects a slower market outlook for general industrial and emerging markets and incorporates the deceleration we saw during the second quarter. Our plan still calls for solid 4% organic growth as we execute our robust pipeline of growth catalysts, which will deliver above-market share gains. Offsetting these headwinds are incremental pricing actions, the initial benefits from margin resiliency and the operational outperformance achieved during the second quarter.

Finally, we expect third quarter earnings per share to approximate 23% of the full year performance while the fourth quarter earnings per share will approximate 29% of the full year earnings. These quarters are slightly different than historical trends due to the timing of various brand transitions on revenue, impact to pricing in response to tariffs and the margin resiliency benefits. In addition, we will have some variation in the effective tax rate for each quarter.

Now turning to the segment outlook on the right side of the page. Tools & Storage assumptions still calls for mid-single-digit organic growth and margin rate expansion year-over-year. As demonstrated with the second quarter performance, the team will continue to leverage price, cost actions, the margin resiliency initiative and volume to offset the external headwinds and deliver operating profit growth. The second half of the year should see a continuation of margin expansion as we anniversary the carryover headwinds from 2018 and take actions to neutralize the incremental List 3 tariffs.

Moving to the Industrial segment. We are now expecting low single-digit organic decline, reflecting the slower market outlook across our general industrial and automotive end markets. Total growth is expected to be positive, including the contributions from our acquisitions. Engineered

Fastening organic growth is expected to decline low single digits, but the second half performance should see a slight improvement sequentially versus the first half as the year-over-year comparables will begin to ease.

Operating margins are expected to be down year-over-year driven by lower volume and the impact from the external headwinds. The Industrial teams are focused on controlling costs and capitalizing on share gain opportunities that often presents themselves during a difficult market backdrop. We fully expect the business to emerge on a stronger position when the automotive market once again turns positive. Finally, in the Security segment, we're expecting positive organic growth and operating margin dollar and rate expansion year-over-year as the team continues to execute on its transformation strategy.

So in summary, for the whole company, we expect 4% organic growth for the full year, 4% to 7% adjusted EPS expansion, which is overcoming close to $400 million of commodity, currency and tariff headwinds. We continue to be encouraged by the collective efforts across the organization through the first half of the year. This strong operational performance puts us in a position to deliver our 2019 EPS guidance while incorporating incremental tariff headwinds and navigating dynamic end markets. We are very pleased to achieve operating margin rate expansion in the second quarter and believe this will continue for the remainder of 2019.

We remain focused on leveraging our continued above-market organic growth, pricing and cost actions. Additionally, we will begin to see the savings associated with the margin resiliency program in the second half. These factors combined will result in operating margin growth and rate expansion for the full year of 2019.

With that, I'd like to turn the call over to Jeff to provide some additional color on the Tools & Storage business. Jeff?

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

Thank you, Don. In Tools & Storage, we maintained our Q1 momentum, led by another strong performance in North America and Europe. Our continued focus on innovation-led growth and the ongoing execution of brand initiatives were key drivers to this success and share gain. Notably, our innovations in cordless and corded outdoor products across DEWALT, Craftsman and Black & Decker have enabled a fantastic outdoor season where we are up mid-teens organically year-to-date.

In Craftsman outdoor, we launched a broad range of cordless products for the season with the 60-volt system catering to outdoor enthusiasts and 20-volt range designed for residential use. In DEWALT, we also launched new 60-volt outdoor products, which are part of our FLEXVOLT battery platform. They're delivering growth in addition to our 20-volt outdoor line. We're seeing strong POS across the portfolio as DEWALT outdoor continues to gain traction in the market. More broadly, our DEWALT 20-volt line is the largest professional cordless system in history with over 250 products augmented by the recent launch of DEWALT Atomic series, which is the best-in-class power-to-weight ratio product.

We're also pleased with the launch of our 12-volt DEWALT Xtreme series, a range of performance-packed offering power tool and organic solutions for a variety of applications. With this program just beginning to shift, we expect to see incremental growth in the pro power tool space in the back half of the year.

Our DEWALT cordless battery platform continues to expand, are serving a broad spectrum of end users from heavy-duty applications with large power requirements via FLEXVOLT to compact applications in the mechanical, electrical and plumbing and pro user segment via our DEWALT Xtreme and ATOMIC range. This broad category innovation has been accelerated by tremendous brand execution across DEWALT, Stanley, Stanley FatMax, Irwin and Craftsman, all of which are positive year-to-date.

Lastly, a word on Craftsman. Overall performance and customer rollouts remain on track, and we continue to be well on our way to delivering 3 points of incremental growth in 2019 and our $1 billion target by 2021. The most satisfying part of the Craftsman relaunch has been our redesigned products are winning with the end user and delivering growth and share gains for us and our customers.

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

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

Thanks, Jeff. Great quarter.

So to recap, we had strong operational performance in the second quarter serving us well in this dynamic external operating environment. Partially due to the outperformance based on margin rate accretion, we're able to reaffirm our full year guidance today despite somewhat slower end markets, especially in industrial/automotive.

As we look to close out a successful 2019, we are focused on day-to-day execution and operational excellence in accordance with our SFS 2.0 operating system. This includes continuing to leverage our organic growth catalysts, building momentum and realizing early benefits from the margin resiliency program, successfully integrating our recent acquisitions and generating strong free cash flow. I'm confident that our seasoned management team will bring the same level of passion, intensity and agility that we demonstrated in the first half to successfully deliver the second half of 2019 while, at the same time, preparing for a strong 2020 and beyond.

Dennis, we are now ready for Q&A.

**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.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from Julian Mitchell with Barclays.

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

Maybe just my question would be around the phasing of the gross external headwinds and what that means for operating margins in the second half. So I think your guidance implies about $120 million of gross external headwinds left for the second half. Maybe help us understand how much of that falls in the third quarter.

And just following up on the commentary on margin expansion for the rest of the year that I think you'd said. Are you saying that Q3 margins will be up year-on-year as well? Or it was just a general second half comment?

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

Okay. So you are correct with the $120 million in the back half of the headwinds. That's an accurate calculation. And then the third quarter would -- the split would be roughly $75 million to $80 million in the third quarter and the remainder in the fourth quarter so a bigger amount hitting in the third quarter as things like commodity continue to tail off, et cetera, and then we obviously have new headwinds in both quarters from tariffs. So that would be the split that we're seeing.

And we do expect margin expansion both in the third and the fourth quarter. However, the third quarter will be probably a modest expansion in the 20 to 40 bps range. And then we'll see a larger expansion in the fourth quarter as a lot of the actions that we're taking in response to the new tariffs such as pricing will get a full effect in the fourth quarter. And then some of the margin resiliency things we've been working on, that will grow across the back half of the year, and we'll see a larger impact in the fourth quarter, hence why we see bigger expansion in the fourth quarter.

**Operator**

Our next question comes from Nigel Coe of Wolfe Research.

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

Maybe just, Jim, you talked about deceleration through the quarter. Maybe just talk about how June trended for you guys. You didn't mention weather, so congrats on that, but I'm sure weather was a factor. And maybe just touch on inventory headwinds that you saw at big-box channels. And then I'll leave it there.

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

Yes. We don't want to get too much into the month-by-month data, but it's sufficing to say that we didn't really see a significant slowing in the construction and DIY-type markets. The slowing was predominantly in the industrial, general industrial and specifically automotive sectors of our business. So our DIY, construction and those types of tools held up very well. I mean we've got POS as strong as I've ever seen in 20 years. So if the market's slowing, it's not slowing for us in that part of the business.

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

in that part of the business-- right.

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

And then a lot of inventory correction we saw over in the Industrial channel, and we saw other corrections that were modest in different parts of the company. That's just normal-course activity, though.

**Operator**

Our next question comes from Michael Rehaut with JPMorgan.

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

The first question I had was on the core organic growth. The tools business continues to perform very well. Just wanted to understand, given some of the comments around Industrial, which might not as much impact the tools segment, more perhaps the other segment, but your comments around some slowing of end market, emerging markets, et cetera. How do you expect the back half to play out from an organic growth standpoint 3Q versus 4Q?

And then just lastly, if I could sneak a clarifying question as well. Don, you mentioned the tax rate impacting 3Q, 4Q results. A little more detail there, if possible.

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

Sure. So the organic Tools & Storage performance, as we mentioned in Q2, was 5% organic growth. And we had a little bit of negative decline in some of the industrial channels that we serve for industrial tools, about 2% of a decline in those particular businesses so nothing significant. We do believe as we look at the back half of the year for tools that we're -- we think the organic growth is somewhere between 5% and 6% for the back half, with the quarters being pretty much in that range for both quarters. So the trend that we saw in the second quarter feels like the right trend as we go into the back half of the year, and so we've shown a little bit of moderation in the Industrial section of the tools business.

And on the tax rate, the third quarter tax rate is kind of 25% to 26%. And the fourth quarter will be around 15% to 16%.

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**Operator**

Our next question comes from Nicole DeBlase with Deutsche Bank.

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

So just one quick one on 3Q versus 4Q ramp. I didn't hear you guys talk about organic growth for the 2 quarters. I know the comp is a little bit easier in the third quarter, a little harder in the fourth, so just how to think about the 4% for the rest of the year. And then on Tools & Storage, did you guys see the 3-percentage point benefit for Craftsman this quarter implying that just underlying market was kind of flattish?

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

So on the third and fourth quarter organic growth, 4% for the year, when you look at the third and fourth quarter split, third quarter is a little bit below the 4%, fourth quarter is a little bit above the 4%. We have to remember, in the fourth quarter, there's a lot of activities that will be happening around the brand transition in particular, so we'll see a positive impact from that. We'll see some of it in the third quarter as well, but we'll see a bigger ramp most likely in the early part of the fourth quarter. So that's just something to consider as you think about the performance.

On the Craftsman side, yes, we saw a significant impact of about 3 points related to the Craftsman rollout. And so as you saw from the performance, in North America, we had a very strong high single-digit retail performance across many of our key customers, and that just related to Craftsman. Certainly, Craftsman was a significant part of that. But then we saw some negative performances in emerging markets. I mentioned the 3 countries that were contracting. And we saw some positive performances in the European market. So overall, it kind of netted to a relatively small number, but we had some significant pockets of growth as you look at them.

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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*

Maybe just touching on Europe a little bit. I think accelerating organic growth in that region is pretty impressive. So I'm just thinking, as you look over the next 12 months, just the sustainability of a mid-single-digit type organic growth number in Europe and the programs that may be supporting that, add some color. And then what do you think Europe on an underlying basis in tools is actually growing, the market?

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

So I'll take that one. This is Jeff. We're quite optimistic for the remainder of the year in Europe. So if you remember, we had a little more than 2% growth -- organic growth in Europe in the first quarter, 5% here in the second. And we feel comfortable with that same type of growth rate in the back half, really driven by share gain.

If you look at the results we're posting, we've been up somewhere between 8 of 10 and 10 of 10 total markets for the last several years, and that trend continues. So the expansion and growth of DEWALT, Stanley, brands like Facom, et cetera, in Europe have been extraordinarily positive, so we feel very good about it. And I think our intelligence would tell us that the European tool business is growing well less than half of that, is what we think, probably less than 2%, and we're probably going to be end the year closer to 5%. So we feel good about it, but again, it's probably more share gain than it is robust end market.

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**Operator**

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

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

Say, the SG&A, I know you have the cost-reduction program rolling through, that $60 million, I think, per quarter on that $250 million program announced last year, and that seems to be phasing well. But as you think about this program and some other programs that you may be unfurling for the balance of the year, SG&A -- and then thinking about into next year, is this permanent? Or should we think about some of these costs coming back next year if growth is better next year?

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

Yes. I would say that the vast majority of this is permanent change. Like any time you do a cost-reduction program, you make decisions maybe to freeze merits and some other things that are definitely temporary, but those are modest when you look at the total impact of $250 million. And so -- and as we think about margin resiliency initiatives going forward, those will be permanent kind of process, sustainable structural changes in how we do business to make us more efficient and effective in meeting the needs of our customers and as we work with our vendors and other partners across the business. So the margin resiliency initiative is really about sustainable, permanent change.

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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 just want to follow up, Don, on your point on the 3Q versus 4Q phasing, and you mentioned that price was part of it. And I know that there's probably a lot of little things that add up to that third quarter versus fourth quarter EPS growth rate. But if I remember, last year, the expectation for price in the fourth quarter was pretty high, and then ultimately, with promo activity and, I think, seasonally just having a harder time getting price in the fourth quarter given the holiday, that ends up being kind of a long putt. Is there something different about how you're expecting to go through that process this year or something that you think has changed in the market from a pricing perspective?

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

Yes. I would say part of what's happening in the fourth quarter is price because we get a full quarter impact versus the third quarter getting a partial impact. But the bigger impact of why our earnings are up -- or will be up in the fourth quarter is that the dollar volume for revenue is expected to be significantly higher than the third quarter given that we have various brand transitions that we'll be executing on. We expect the Industrial segment to perform at a higher level given it had a very difficult fourth quarter last year and they're anniversary-ing some of those headwinds. And then obviously, we expect Security to demonstrate some growth as well.

So it's all those different factors, but if you look at a 4.5% roughly organic growth performance in the fourth quarter, you're going to get to a sequential growth number in revenue that's close to $250 million to $270 million. And as that flows through to operating margin and eventually earnings, that's going to be a significant reason for the higher level of performance, combined with all the other little things that you mentioned like price, margin resiliency, et cetera. The tailing off of commodity inflation, that's going to happen more in the fourth quarter versus the third quarter. It's all those different factors that are going to drive that.

I think one of the things that I didn't mention but I will mention now is that when you look at the operating margin dollars as a percentage of the full year, the percentage in the third quarter isn't dramatically different than the percentage in the third quarter of last year. And so when you look at the OM dollar percentage for the full year by quarter, you look -- the first quarter was lower by about 2 to 3 points versus last year. The fourth quarter is going to be higher by 2 or 3 points for the reasons I mentioned. But the 2 quarters in between are pretty much in line with last year's performance when you look at that level. And you can do the same thing pretax, it's relatively the same thing. It's really when you get down to EPS that you see a bigger deviation because of the tax rate.

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**Operator**

Our next question comes from Deepa Raghavan with Wells Fargo.

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

Great quarter. Obviously, a lot of moving pieces within your guidance. Can you talk through some of the items that positively surprised you in the quarter? It could be with your pricing initiatives or cost actions, whether it was end markets or regions that surprised you favorably. Or what also was unfavorable versus your prior thoughts? Relatedly, are you seeing any incremental pushback or demand impacts from these continued price increases that you are leveraging in the market?

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

Okay. So I'll take the first part and then maybe I'll pass the second question over to Jeff around pricing. But as far as the quarter, what things we saw that were a little bit different than expectation, emerging markets clearly was slower. To some extent, we expected some slowness especially in Argentina and Turkey, but Mexico was a bit of a surprise given the events that happened in the middle of the quarter around the threats of potential tariffs had seemed to slow the markets a little bit in the back half of the quarter. So that was certainly a little bit different than expectation. When I look at kind of the retail tools performance, I think we'd say it pretty much was in line with expectation, no real unusual surprises or -- either positive or negative in that regard.

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

Although I think the POS was a positive surprise. The load-in was kind of as expected but...

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

Low double-digit POS is always a positive, probably above expectations. That's a fair point, Jim. But as far as our kind of revenue performance, there really wasn't anything that really stood out as unusual. But that's a great positive trend as we think about execution in the back half of the year, especially the third quarter. And then Industrial is slowing down a little bit, as we mentioned, and the industrial tool business was a little bit different versus expectations. However, we expected a lot of that slowness in our Industrial segment.

Jeff, you want to take the price question?

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

Yes. Maybe 2 things there. When we talk about industrial within tools, the industrial construction part of our business, which is the hard-core construction part of the business, continued to perform really well. POS was great. Growth was great. When you get into heavy-duty manufacturing industrial like the industrial storage business and some of those things, they were pressured. So we just continue to win in every part of construction. It was more the industrial manufacturing part that was pressured a bit in the quarter.

In regards to price and POS, we've done everything we can to deal with the effects of price inside of our business. And then that has required us to pass on price to our customers as well because we -- there's no way we could contain it all. But even as we've done that in the last -- in the year-to-date basis, we're up double-digit POS on a year-to-date basis, and that's from everything, from outdoor through cordless power tools, brands, everything. So we feel like we've done a really good job of managing price and volume to this point. In the future, we'll continue to stay really close to it, but we feel like we've done a pretty good job with our customers of managing the volume/price equation. And as a result, robust POS is driving growth for us and our customers.

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

Yes. And I think the other positive, even though it's not a huge positive versus our expectations, but the fact that Europe has been able to continue to be very strong even in the face of tremendous uncertainty over there, everything. Every -- almost every country you look at, you see political -- geopolitical turmoil and economic stress and just limited growth. And so I think that kind of mid-single-digit growth performance in Europe continue to sustain that, and I think that bodes well as well, as Jeff said, for the second half in Europe.

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**Operator**

Our next question comes from Robert Barry with Buckingham Research.

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

Just a couple of quick follow-ups. I think you were expecting tools margins to be only very modestly up in 2Q and then much more meaningful in the back half. And it looks like 2Q ended up being more meaningful and now 3Q is going to be only pretty modest. So just curious what kind of drove the outperformance in 2Q or why that kind of shift is happening.

And then just a quick follow-up on the Craftsman channel loading. When does that peak, that contribution to growth?

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

Okay. I'll start with the margin question and pass the Craftsman question over to Jeff. Yes, we expected modest rate accretion in the second quarter for Tools & Storage. We ended up getting close to 80 bps of accretion in the second quarter. We still expect good accretion in the third quarter, not quite as much as 80 bps but still very healthy performance, and then it gets even stronger in the fourth quarter.

The second quarter really is just a factor of us being very focused on how we manage; as I mentioned in my comments and we've mentioned a fair -- several times over the last year, really that balance between volume growth, pricing and making sure that we are focused both on organic growth and margin rate accretion performance. And I think the tools team did a great job managing that dynamic in the second quarter to get this type of performance. It's a little bit of timing related to tariffs where some of the tariffs shifted into the third quarter related to the new List 3, ones going from 10% to 25%. That was a little bit of a positive that didn't impact us in Q2 just given the timing of it. But beyond that, it was really just strong execution by the tools team.

Jeff, you want to take the Craftsman question?

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

Sure, Don. In regards to the question on Craftsman loading, I would say probably the loading itself anniversaries, to a large degree, in the fourth quarter. So if you look at the rollouts, we've been rolling out Craftsman for -- on an increasing basis over 6 quarters. So it really -- it's the fourth quarter where it starts to anniversary most of the largest loads.

At the same time, we stay really close to that POS. And I think we've said before, and I'll say it again, the POS in Craftsman tend to be almost twice what it replaced in the categories that we've added it. So even though we're anniversary-ing the loading, we still feel really good about the 3 points of incremental growth and our path to $1 billion by 2021. So both of those things are -- they are positive at this point.

**Operator**

Our next question comes from Ken Zener with KeyBanc.

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

Jeff, I wonder if you could comment. In the old days of Black & Decker, the outdoor power tool group had an effect on 2Q. Obviously, with your growing investment and insight into the outdoor power tool and given the very wet second quarter, could you comment on any perhaps drag you saw there, but also, for whoever, how that might affect the execution of -- when you get a more -- it was a great business, but it becomes more seasonal, how that kind of affects perhaps operations or how you'd approach a very wet winter and how we should think about that going forward?

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

Well, our result in outdoor has been really good, so we're up mid-single digits, by 15% on a year-to-date basis; some weeks, 19%. And the best intelligence we have says the outdoor space would be up about 1/3 of that. So that clearly represents share gain across Black & Decker, Craftsman and DEWALT.

And I think the thing that's changed over the last 25 years I've been in the outdoor business is we've become a much more prevalent player for a longer part of the season. So while we historically participated in the spring part of the outdoor season, we've gotten far, far better at other categories where now that's elongated well into the fall and early winter, blowers and some of those things that we historically hadn't done. So if you think about it that way, we ship those products in Q1. They sell in Q2. Blowers and so forth happen in Q3.

So outdoor has become -- it's a seasonal business, but it's now 3 quarters of our year versus what used to be 1 quarter of our year. And so all in all, I don't think -- the season hasn't impacted us. And I think the season in total was up a bit in the market, but ours was probably 3x the market growth. And we feel good about that same prospect for the fall as well. We have really good promos and listings and so forth.

**Operator**

Our next question comes from Michael Wood with Nomura Instinet.

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

Can you give us any initial quantification of the 2020 carryover, external headwinds from tariffs, FX, commodities; and potential offsets with the carryover from your cost actions? And you also called out less commodity inflation. Just curious if you could pinpoint where you're seeing that. And does that become a year-over-year tailwind by year-end?





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

Yes. So obviously, we'll have a carryover impact from the List 3 tariffs going from 10% to 25%. So we only have about a half year impact of that this year. That's roughly $70 million of an impact in 2019, so you can expect that to be roughly the same in 2020. The commodity impact or deflation impact or lower inflation is probably $15 million to $20 million this year, most of that hitting the fourth quarter.

So we would expect a little bit of a carryover impact from that. It's coming from things in -- certain steels and resins primarily that's driving it, but we're also seeing it in a couple of other categories. It's kind of spread across various different categories. No one big one driving all of it. So if things stay where they are, we would expect a carryover impact that may be as reasonably close to the tariff impact at this stage. So hopefully, they neutralize themselves as we look at it right now.

**Operator**

Our next question comes from Sam Darkatsh with Raymond James.

**Joshua Kenneth Wilson** - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

This is Josh filling in for Sam. I want to dig into the incremental pricing. You maintained your organic growth guidance for the year but with lower volume expectations, offset by some incremental pricing. Could you give us some more color on which segments and which geographies that incremental pricing is coming in? And what gives you confidence those markets will support those increases?

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

Well, I mean, we've been -- as you know, we've been getting price in the market for over a year now related to all these different headwinds. And so some of these are going to start to anniversary themselves in the back half of the year, so you will have had a full year impact. We will have new pricing actions related to the List 3 going from 10% to 25% in the back half of this year.

We've been running at about a 2-point price impact. I would expect that probably would be somewhere between 1 to 2 points in the back half of the year. Given that we're starting to anniversary, some of these things are likely being maybe closer to 1 versus 2. So the impact of price on our organic growth will be a little bit smaller than what we've experienced in the first half of the year. And then obviously, the offsetting impact to get to 4% organic growth will be volume, which means it'll be a little bit bigger versus what you just mentioned.

**Operator**

Our next question comes from Ross Gilardi with Bank of America.

**Ross Paul Gilardi** - *BofA Merrill Lynch, Research Division - Director*

I was just wondering -- I figure I'd throw in a question on the Security business. I was interested in your comments on improving trends. In what parts of the business are you seeing strength? And then just more broadly, while you're clearly making a little margin progress, you're still a long way from the mid-teens operating margin objective that you want for the business. How will you look at it next year if you're still making positive progress but you're still well short of your margin targets, with respect to retaining or divesting the business?

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

Well, the retaining or divesting of the business question is a question that we promise to answer a year, 2 years from a year ago in May. And right now, we're not speculating on all these different aspects of -- and scenarios, what-ifs and so on. What we're focused on is margin improvement and organic growth and transformation of the business model to make it a more relevant business model and a more defensible business model for the 2020s. And regardless of whether we elect to keep it or divest it, either way, the value that we're creating by focusing on this is substantial, and that's the way we're thinking about it right now.

We don't want to distract ourselves with having to evaluate what's the right time to divest, should we divest, what's the right divestiture approach if we choose to do that. I mean there's a lot of complexities associated with those questions which we'll answer at the appropriate time. But for now, we're focused on margin improvement, which we've accomplished the beginnings of now, and we're -- and it's mostly in electronic business. I'd tell you it's across the board in the electronic business where we're focused on margin improvement. And now we're moving -- now that we have that going, we're moving to an extreme focus on driving the value proposition and the go-to-market feet on the street selling the applications that we've developed.

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**Operator**

This concludes the Q&A 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 again for calling in this morning and for your participation on the call. Obviously, please contact me if you have further questions. Thank you.

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**Operator**

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

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