THOMSON REUTERS

EDITED TRANSCRIPT

Q4 2018 Stanley Black & Decker Inc Earnings Call

EVENT DATE/TIME: JANUARY 22, 2019 / 1:00PM GMT

CORPORATE PARTICIPANTS

Dennis Lange *Stanley Black & Decker, Inc. - VP of IR*
Donald Allan *Stanley Black & Decker, Inc. - Executive VP & CFO*
James M. Loree *Stanley Black & Decker, Inc. - President, CEO & Director*
Jeffery D. Ansell *Stanley Black & Decker, Inc. - Executive VP & President of Tools & Storage*

CONFERENCE CALL PARTICIPANTS

Jeffrey Todd Sprague *Vertical Research Partners, LLC - Founder and Managing Partner*
Joseph Alfred Ritchie *Goldman Sachs Group Inc., Research Division - VP & Lead Multi-Industry Analyst*
Joshua Charles Pokrzywinski *Morgan Stanley, Research Division - Equity Analyst*
Julian C.H. Mitchell *Barclays Bank PLC, Research Division - Research Analyst*
Justin A. Speer *Zelman & Associates LLC - MD of Research*
Michael Jason Rehaut *JP Morgan Chase & Co, Research Division - Senior Analyst*
Michael Robert Wood *Nomura Securities Co. Ltd., Research Division - Research Analyst*
Nicole Sheree DeBlase *Deutsche Bank AG, Research Division - Director & Lead Analyst*
Nigel Edward Coe *Wolfe Research, LLC - MD & Senior Research Analyst*
Richard Michael Kwas *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*
Robert Douglas Barry *The Buckingham Research Group Incorporated - Research Analyst*
Susan Marie Maklari *Crédit Suisse AG, Research Division - Research Analyst*
Timothy Ronald Wojs *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

PRESENTATION

Operator

Welcome to the Fourth Quarter and Fiscal Year 2018 Stanley Black & Decker Earnings Conference Call. My name is Shannon, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded.

I will now turn the call over to the Vice President of Investor Relations, Dennis Lange. Mr. Lange, you may begin.

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

Thank you, Shannon. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's Fourth Quarter and Full Year 2018 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 a 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 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 fourth quarter and full year 2018 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'll 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.

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

Okay. Thanks, Dennis, and good morning, everyone, and thanks for joining us.

As you saw in today's release, we delivered a respectable fourth quarter, continuing our trajectory of above-market organic growth and delivering strong EPS growth and solid free cash flow dollars and conversion.

As many of you know, in 2018, we faced an unusual and sudden onslaught of large and volatile external headwinds, most of which developed during the course of the year, specifically pressure from input cost inflation, FX and tariffs had, by fourth quarter, grown from our initial January guidance of $150 million pretax to $370 million, which at the EPS level, would have been about 25% dilutive to prior year EPS had we not managed to offset all but $50 million of that with additional price/cost management and other actions. The fact that we ended up delivering 9% adjusted EPS growth in 2018 on 8% revenue growth, which included 5% organic, is quite remarkable. It speaks volumes as to how agile our experienced management team deals with short-term adversity and operating environment challenges while continuing to pursue above-market growth and moving the company forward strategically.

More on that in a few minutes, but first, a few words about the fourth quarter. Revenues were up 5% to $3.6 billion with organic growth of 6%. Tools & Storage delivered 7% organic with strength in all major geographies and business units. The Tools growth was driven by the continued rollout of the Craftsman brand, price realization and leveraging our portfolio of growth catalysts. Industrial delivered 14% total revenue growth inclusive of the Nelson Fastener acquisition, and organic was up 4% for Industrial. The Oil & Gas business exceeded our plan this quarter and delivered a robust 27% organic growth derived from increased pipeline project activity in North America. Our total company adjusted operating margin rate was 13.3% as volume leverage, price and cost actions were more than offset by the impact of currency, commodity, inflation and tariffs.

Security was a bright spot this quarter, delivering both operating margin dollar and rate improvement versus a year ago. The Security team is energized and focused, and we are looking forward to realizing a significant and growing benefit from that business' transformation as 2019 unfolds.

EPS for the quarter was $2.11, in line with expectations.

And now I'll turn to full year highlights. Full year revenues were $14.0 billion, up 8%, including 5% organic growth and 3 points from acquisitions. Excluding charges, diluted EPS for the year was $8.15, a 9% increase versus 2017, and our operating margin rate remained solid at 13.6% despite absorbing the $370 million of headwinds previously mentioned.

Turning to capital allocation. We continued our balanced approach once again in 2018. During the year, we repurchased $500 million of our shares and increased the dividend once again, the 51st consecutive year of increases. From an M&A point of view, we closed on Nelson Fasteners, which further diversifies the Engineered Fastening business into industrial markets. We also announced the IES Attachments acquisition and our entry into large outdoor power equipment with MTD as our equity partner. We're excited to see these opportunities progress and fuel future growth in the coming years.

In summary, 2018 was a successful year, one in which we cut through challenges to deliver solid results. This performance is attributable to the agility, passion and dedication of our workforce, and I want to take this opportunity to thank every employee for their commitment and their resolve because it is our people to whom we attribute this great culture and the passion to perform well in any environment. They live our purpose every day with incredible energy and commitment.

As we enter 2019, the external challenges don't magically disappear. However, we are well-prepared and positioned to tackle them. In addition, there are signs that the global economic growth is slowing and that the U.S. economy may soon be coming to the end of one of the most enduring recoveries in U.S. history. We are leaning into these challenges and will leverage our SFS 2.0 operating system while deploying an impressive array of growth and margin improvement initiatives to once again be successful in 2019.

The investments we've made to support organic growth and our recent acquisitions have created the strongest pipeline of revenue-generating catalysts we've ever had during my almost 20 years as a C-level Executive in this company. These opportunities will provide a foundation for continued share gain and can act as a buffer to the revenue impact that could result from potentially slower markets.

We will see benefits in 2019 from the rollout of the Craftsman brand, the largest product program in our history, as well as the repositioning of the Stanley and the Stanley FatMax brands in the North American home center channel. With these programs, we are unlocking new opportunities for share gain by aligning our brands across core user groups within the Tradesman and Professional segments while leveraging our brands fully with our retail partners.

The response we have seen from our customers and end users with the Craftsman rollout encourages us regarding the potential for 2019 and beyond. Our core and breakthrough innovation initiatives are stronger than ever, and our innovation focus permeates the entire company. We expect to see future revenue benefits not only from FLEXVOLT, which is a well-traveled story, but also from new innovations coming to market in Tools, Fastening and other Industrial businesses as well as Security.

In terms of the Lenox/Irwin acquisitions, we're attacking the revenue synergy opportunities which will represent $100 million to $150 million of organic growth over a multiyear period as we broaden the distribution of these products around the world.

In the emerging markets, we continue to deliver outsized growth and share gain, and we are leveraging our unique business model, the strength of our brands, including Stanley-branded midpoint -- mid-price-point corded and cordless power tools as well as hand tool products. And we're having immense success growing at 2 to 3x the market rate. And across both developed and emerging markets, e-commerce remains a key revenue growth driver for us. This year, it represents a $1 billion high-growth business, a channel in which we are the industry leader across the globe by a wide margin.

And turning to our recent acquisitions, in addition to the organic growth opportunities I mentioned with Craftsman and Lenox/Irwin, we expect to generate inorganic growth from the IES acquisition in 2019, for which we are waiting government approvals.

Additionally, as I said earlier, our MTD partnership is just getting started, and we are excited about the future benefits from this relationship. As part of the deal, we have secured an option to purchase the remaining 80% in 2021 and beyond for an amount which should approximate 7 to 8 times EBITDA. This provides clear visibility to almost $3 billion of instant growth in the early 2020s at what will truly be a great acquisition price based on the joint value-creation efforts underway between the companies.

So with all these incredibly robust growth catalysts, we are in an excellent position for a successful march to $22 billion of revenue by 2022. In fact, we are so well positioned that we are now shifting our near-term emphasis from identifying and acquiring new growth catalysts to: first, continuing to execute the ones that we already have; and then second, focusing on margin rate accretion.

For starters, we will leverage our $250 million cost-reduction program, which is substantially complete, as well as pricing and productivity benefits in 2019. Beyond that, we are now in the process of developing and executing an array of margin expansion initiatives, many of which are aided by applying new modern technology such as elements of Industry 4.0 and advanced analytics. More to come at our investor meeting in May, but rest assured, this will be a powerful and substantial initiative that will generate future margin accretion and buffer our earnings and cash flow from the vagaries of economic cycles and the external operating environment.

In addition, we have redirected our capital allocation in the short term to a deleveraging posture, keeping the balance sheet in a prudent place as is appropriate for this stage of the cycle. This will give us maximum flexibility in the future for opportunistic repurchases and for acquisitions as our long-term capital allocation strategy of 50% back to the shareholders and 50% reinvested in growth remains intact.

So in summary, there's a lot to be excited about with this powerful growth story. And now adding the additional focus on margin expansion will ensure that the benefit of all this revenue growth makes its way into even higher growth rates for operating margin and EPS.

And now I'll turn it over to Don Allen, who'll walk you through more detail in the segment performance, overall financial results and 2019 guidance. Don?

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 fourth quarter.

Tools & Storage delivered 4% total revenue growth, with 7% organic growth and a 3-point headwind from currency. Organic growth included 5 points of volume and 2 points from price. We continue to see sequential improvement in our price realization, which represented a full quarter benefit from the price actions we executed during the third quarter. The operating margin rate for the segment was 15.4%, down from the prior year as benefits of volume leverage, pricing and cost control were more than offset by the impacts of currency, commodity inflation and tariffs. The impact of these headwinds amounted to $135 million for Stanley Black & Decker. Approximately 90% of this figure impacted Tools & Storage in the fourth quarter.

The strong organic growth and related share gains were experienced across each Tools & Storage region and SBU. First, on a geographic basis, North America was up 10% organically with strong performances across all channels. U.S. retail and U.S. commercial markets both posted low double-digit growth, and our industrial and auto repair markets generated mid-single-digit growth.

North America's growth continued to be fueled by new product innovations, including FLEXVOLT, the Craftsman brand rollout and price realization. The Craftsman rollout is continuing to be well-received by end-users and our customers. For the year, it drove close to 2 points of revenue for Tools & Storage, net of cannibalization. We are excited and encouraged about the success we are seeing as we continue the rollout in 2019. More on that from Jeff a little bit later.

Europe delivered 4% organic growth in the quarter. 9 out of 10 markets grew organically, an impressive performance as we did see some weaker market conditions in Europe. The team once again leveraged our strong portfolio of brands and expanded our retail relationships to produce above-market organic growth.

Finally, emerging markets delivered 3% organic growth. Diligent price actions to offset currency headwinds, Lenox/Irwin revenue synergies as well as a continued focus on e-commerce and the ongoing MPP launch continued to support growth in this part of the Tools & Storage business. These actions were partially offset by severe market contractions that we saw in Argentina and Turkey. These 2 markets reduced growth by approximately 360 basis points, and that is not unexpected, given the recent foreign exchange volatility we've seen in those 2 countries. However, Latin America continued to be strong with double-digit growth. Brazil, Colombia, Ecuador, Chile and Mexico had high single-digit or double-digit organic performances. Additionally, in Russia, India, Korea and Taiwan, they all posted high single or double-digit organic growth as well.

Now taking a look at the Tools & Storage SBUs. All lines showed high single-digit growth in the quarter. Power Tools & Equipment delivered 7% organic growth and benefited from new product introductions and strong commercial execution. FLEXVOLT delivered a robust mid-teen growth for the year while delivering improved profitability, which is now in line with the overall segment average. Hand Tools, Accessories & Storage delivered 8% organic growth as new product introductions, the continued Craftsman rollout and then solid performances within the construction and industrial-focused product lines, and of course, the contribution from Lenox and Irwin revenue synergies, all these items contributing to their growth.

In summary, an excellent quarter and a very successful year for the Tools & Storage organization with growth in every region. Operating margin for the quarter was strong at 15.4% as the benefits from volume leverage, pricing and cost control were more than offset by what we saw around the headwinds, the currency, commodity and tariffs. This team continues to be resilient and is acting with agility to return this business back to margin expansion in 2019.

Turning to Industrial. This segment delivered 14% total revenue growth, which included 12 points of growth from the Nelson Fastener acquisition and a negative 2 points from currency. Organic growth was 4%, and operating margin rate declined year-over-year to 13.2% as productivity gains and cost control were more than offset by commodity inflation, the dilutive impact from the acquisition of Nelson Fasteners and then an unfavorable revenue mix within the fourth quarter.

Engineered Fastening posted total growth of 14%, which included the contribution from Nelson Fasteners. Organic growth for Engineered Fastening was 1% due to higher system shipments and fastener penetration gains in the automotive business, which were partially offset by a decline in global light vehicle production. The latest global light vehicle production for full year 2018 shows a modest retraction versus the prior year. As demonstrated this year, our Fastener business can still grow in this environment as we increase the fastener content within our customers. For the year, our auto fastener growth was 6%, over 600 basis points ahead of global production.

The Infrastructure businesses delivered robust growth, up 18% organically. This was primarily due to stronger North American Oil & Gas pipeline projects, which contributed an impressive 27% organic growth in the quarter. We also had modest growth within our Hydraulic

Tool business.

Finally, the Security segment declined 1% with bolt-on acquisitions contributing 3 points of growth, which was offset by an organic decline of 2% and unfavorable currency of 2%. North America declined 2% organically as higher volumes in automatic doors and health care were more than offset by lower installation revenues in commercial electronic security. Europe was down 2% organically as growth in Sweden was offset by weakness in the U.K. and France. In terms of profitability, the segment operating margin expanded to 12%, improving 100 basis points versus the prior year.

The Security team continues to make progress on the transformation plan, namely, optimizing our cost to serve while positioning the business to provide new and differentiated offerings to our large key account customers and to our small- to medium-sized accounts. This quarter and the second half demonstrated an important first step toward stabilizing the margin performance of this business by delivering operating margin dollars and rate improvement versus 2017. We expect these transformation initiatives to gain further traction in 2019 as we continue to position the business for meaningful margin dollar and rate expansion and more consistent organic revenue growth.

In summary, it was another promising quarter for Security, with the team delivering year-over-year margin expansion for the first time since late 2016.

Let's take a look at our free cash flow performance on the next page. I would like to highlight that we are presenting the 2017 cash flow amounts as previously reported and exclude the impacts of the new accounting standards that were adopted in January of 2018. We believe that presenting the cash flow results in this manner provides a more meaningful comparison of the company's operating cash flow performance.

Similar to past years, we were able to drive significant working capital improvements during the quarter. Our full year free cash flow performance was solid as we generated $769 million in 2018. Cash from operations declined $158 million versus 2017, which was driven by higher tax payments due to the addition of the toll charge that was included within U.S. tax reform, and we also had higher M&A-related payments. We saw our capital expenditures increase by $49 million in 2018 as we made investments to expand our manufacturing and distribution capacity, made technology investments to support functional transformation and Industry 4.0 and invested to support our acquisition integrations. This performance resulted in free cash flow as a percentage of net income of approximately 119%.

Excluding the noncash net charges associated with U.S. tax reform, free cash flow conversion was approximately 90%, in line with expected -- expectations communicated in our October earnings call.

From a working capital turn perspective, we delivered 8.8 turns in the fourth quarter, a decrease of 0.3 turns versus the prior year. This decline is primarily due to carrying higher levels of inventory to support the Craftsman rollout and, to a lesser extent, the dilutive impact from the acquisition of Nelson.

Working capital management remains a key pillar of the SFS 2.0 operating system. We continue to drive working capital improvements across the company, with heavy focus on improving the performance of our recent acquisitions and eventually moderating the inventory levels from our tools, brands, transitions that are happening right now when we feel that's appropriate. We are confident in our ability to bring our working capital turns back above 10 in the coming years.

Now let's move deeper into our 2019 guidance. We are targeting approximately 4% organic growth in 2019 with an adjusted earnings per share range of $8.45 to $8.65, up approximately 5% versus prior year at the midpoint. The free cash flow conversion will be approximately 85% to 90%. The free cash flow conversion is slightly below our historical performance and long-term targets due primarily to 2 factors: One, we are expecting that much of the cash payments associated with our Q4 2018 cost-reduction program will occur in 2019; the second factor is the ongoing cash payment associated with the toll charge that we'll see for the next 7 years. Over the long term, we are still confident that a conversion rate of approximately 100% is still achievable as we use our Core SFS principles to drive working capital out of the system.

On a GAAP basis, we expect earnings per share to range from $7.45 to $7.65, which is inclusive of various onetime charges related to M&A as well as some onetime costs related to our margin enhancement initiative that Jim just discussed, also including the ongoing Security transformation.

Turning to the drivers of core EPS growth you can see on the left-hand side of the chart we expect the benefits from organic volume to generate $0.30 to $0.40 of EPS accretion. The cost-reduction program we executed at the end of 2018 is expected to deliver $1.05 of EPS, which is a net of a modest set of investments to support value-driving activities such as Industry 4.0, advanced analytics and our Security transformation. These items will be partially offset by $0.90 to $1 of incremental tariff, commodity inflation and currency headwinds, net of both carryover price benefits and new pricing actions implemented earlier this year in response to tariffs. We expect a tax rate of approximately 17.5%, which represents a $0.15 EPS headwind year-over-year. And then lastly, the benefits from the MTD partnership and the lower share count, partially offset by higher interest expense, should deliver a positive $0.10 in EPS.

I would highlight that we have included Section 301 List 3 at a 10% assumption for the full year. If this does increase to 25%, it could represent a gross headwind of approximately $100 million before pricing and other mitigation efforts. As you read in the release and heard from Jim, we are preparing to take additional cost and margin-driving activities to insulate ourselves from this and other risks. Also, as you know, we always build a level of contingency to ensure that we can deliver our guidance and absorb a certain level of unknown market or external headwinds, and we will continue to do that in 2019.

I would now like to review one other miscellaneous guidance matter. We expect the first quarter earnings to be approximately 13% of the full year performance. This is about 400 basis points lower than last year. The primary factor driving this lower percentage of full year delivery is that we continue to expect elevated levels of external headwinds, particularly in Tools, which from a profile perspective, are more heavily weighted towards the front half of the year. This will cause the first quarter to show operating margin rate and dollar retraction as we have a headwind of approximately $125 million to $135 million, net of pricing benefits, which is nearly 3/4 of the expected $170 million full year net headwind.

Now turning to the segment outlook on the right side of the page. Organic growth within Tools & Storage is expected to be at mid-single digits in 2019. There are multiple catalysts supporting growth, including: Core innovation; continued benefits from FLEXVOLT; the Lenox and Irwin revenue synergies; emerging market opportunities; and the continued brand transitions with Craftsman, Stanley and Stanley FatMax. Margin rates are expected to be positive year-over-year. We are expecting the external environment to continue to be challenging in 2019, presenting another year of large external headwinds, as I just mentioned. However, we will continue to leverage multiple margin levers, including price realization, cost actions, margin-enhancing initiatives and volume to offset these headwinds and position the business for a return to margin expansion in 2019, with stronger performance expected for the second half.

In the Industrial segment, we expect a relatively flat organic performance, reflecting softening conditions within the automotive end market. We're expecting Engineered Fastening to be relatively flat organically with continued growth within automotive fasteners. Our systems outlook reflects a softer year as we have been seeing a more constrained CapEx spending environment with our auto customers. In Oil & Gas, we are planning for low- to mid-single-digit growth, driven by stronger North American pipeline project activity. And then Hydraulic Tools growth will be relatively flat due to slower market conditions in that space. We expect operating margins to be flat year-over-year with productivity and cost actions offset by commodity inflation and tariffs in our Industrial segment.

Finally, in the Security segment, we're expecting the organic growth to be up low single digits in 2019 as the team continues to execute its transformation strategy. This should translate into improved operating margins year-over-year as we continue to stabilize margins and deliver on our initiatives to lower our cost to serve.

So in summary, 4% organic growth, 4% to 6% adjusted EPS expansion despite a 2-point tax headwind, a solid result and a balanced view that acknowledges the current market condition and today's view of the external headwinds, which are front-half loaded. We believe we are taking the appropriate actions to position the company for success in 2019 despite a very dynamic operating environment. We remain focused on our organic growth catalysts, margin expansion initiatives, strong free cash flow generation and successful acquisition integrations.

With that, I will like to turn the call over to Jeff.

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

Thank you, Don. I would like to provide of a few more points on the Tools & Storage performance for the year, including updates on our strategic brand partnerships for Craftsman and Stanley.

We closed 2018 with high single-digit organic growth enabled by record-setting new product launches, best-in-class commercial partnerships and integration excellence. As evidence, Irwin, Lenox and Waterloo have delivered double-digit organic growth since becoming part of Stanley Black & Decker.

Adding to the strong acquisitive performance is Craftsman, which is exceeding both our and our customers' expectations. We're on track to $1 billion in revenue growth by 2021, 7 years ahead of schedule. This progress is being driven by strong user acceptance. As such, we have achieved a 4.6-star rating across well over 1,000 products and outstanding in-store execution by both Lowes and Ace. We also announced last quarter that the Home Depot will now be the exclusive home improvement retailer for Stanley and Stanley FatMax Hand Tools & Storage product portfolios, both in-store and online, beginning this year. The product will begin to ship in the front half of 2019.

Now I'll turn the call back over to Jim to wrap up today's presentation.

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

Thank you, Jeff. In summary, 2018 was a year of solid performance despite the volatile external environment. As we said, we delivered 8% total revenue growth, including 5% organic; net OM rate remained robust at 13.6%; and adjusted EPS grew by 9%.

Our teams acted with speed and agility while facing into and overcoming an unprecedented impact from currency, commodity and tariff headwinds. And while these headwinds will gradually abate as 2019 unfolds, they will be with us for a while, and the economic growth backdrop also looks to be slowing as well. So with that as context, we are pleased that our 2019 outlook calls for 4% organic growth with a 4% to 6% EPS expansion, and we feel good about that.

We remain focused on delivering above-market organic growth with operating leverage, reenergizing our focus on margin expansion, continuing to successfully execute our recent acquisitions and generating strong free cash flow. And as always, our seasoned leadership team will act with agility and leverage SFS 2.0 and all available avenues to maximize our value creation for shareholders.

In other news today, we are announcing that Stanley Black & Decker was named to the Carbon Disclosure A List for both climate change and water. This great recognition is an honor, and it underscores our commitment to continue to conduct ourselves in a socially responsible manner.

I would like to thank my senior management team and all of our Stanley Black & Decker associates around the world as well as all our stakeholders, including the investment community, for your support. We are looking forward to another successful year in 2019 and continuing our pursuit of strong financial performance, pervasive innovation and social responsibility.

Thank you. And with that, we are now ready for Q&A. Dennis?

Dennis 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 Rich Kwas with Wells Fargo Securities.

Richard Michael Kwas ***Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst***

Jim, Don. First, on Jim, so focus on deleveraging here, kind of base level for capital deployment, doesn't seem like this is going to be a year of meaningful M&A. What would you characterize, given where we are in the cycle, of the puts and takes, consideration, in terms of additional M&A? And then, Don, real quick on the free cash flow conversion and the over -- underlying conservatism in the guidance. If you could make some comments on conservatism. And then second, on FCF, is there any working capital headwind with regard to the transition of the Stanley brand to Home Depot?

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

Okay. It's Jim, I'll start. At this point in the cycle, our plan is to kind of go in strong, stay strong and emerge stronger. And that's exactly what we did in '08, '09. If you recall, those that followed us for a long time. When we went into this, the cycle, we actually had our balance sheet in great shape and we continued to maintain as much operating margin and cash flows we could squeeze out of the company even though the revenues were down a little bit. And in '09, at the tail end of all that chaos, we actually negotiated the Black & Decker transaction and transformed the company subsequently. Now I'm not suggesting that we have any plans to do that, such a transaction, again. But what I will say is that it's really amazing when you come out of the end of the cycle and look at all the opportunities that are out there, large and small, that derived from others who had not maintained themselves in the same manner during that downward part of the cycle. So with that, debt-to-EBITDA right now is about 2.6 times, and we are deleveraging this year. We may do 1 or 2 very small emerging market transactions, but that would be about it. And I'd say by the end of '19, we're going to be in really great shape from a balance sheet perspective. We are already, but even better shape, and then we'll see where we go from there.

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

So to your second question, Rich, on free cash flow conversion for 2019 guidance. I mentioned the 2 items that are resulting us being in 85% to 90%, with one being the total charge and then the other being M&A or restructuring-related payments associated with the fourth quarter charge that we took of about $100 million. So most of that cash outflow will happen in 2019.

On the working capital front, we don't actually see a dramatic improvement in working capital turns in 2019 because we do have to continue to work through these brand transitions that we've discussed throughout the last year related to Craftsman, but now also related to what's happening with Stanley and Stanley FatMax in the Home Depot. And we have to make sure that we have the right level of inventory to meet the needs of our customers. And we're not going to get overly aggressive in our supply chain until we work through those transitions. So we're not counting on a dramatic improvement in working capital turns in 2019. But as I mentioned, once we work through that, we can regulate and moderate to the levels that are more historical for us and begin to work our way back to 10 turns over the next few years.

Operator

Our next question comes from Tim Wojs with Baird.

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

I have a quick two-parter. I guess, first, could you just talk about within the Tools growth guidance, what is embedded in there in terms of accretion from Craftsman and the Stanley Hand Tool changes? And then secondly, I was just -- the cadence of Q1 margins being lower, is the implication that Tools' margins be positive through the remainder of 2019? Just want to clarify that.

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

Yes. So if you think about Tools & Storage organic growth, we said mid-single digits. So you interpret what that, but it can range anywhere from 4% to 6%. So it's probably leaning towards, closer to the high end of that range. Within there, we see Craftsman performance net of cannibalization. So when we talk Craftsman net of cannibalization, we're including the impacts of what's happening with Stanley and Stanley FatMax and Porter Cable coming out of Lowes. We believe that impacts probably 2 to 3 points in 2019. And so that kind of gives you a gauge of where we think it is. So it's relatively close to what we experienced in 2018, maybe a little bit better.

The second question was related to -- what was the second question, Dennis?

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

First quarter margins.

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

First quarter margins. So yes, what it does imply, as we look at the second, third and fourth quarter, we would expect to start to see, in the Tools business, margin rate and dollar expansion year-over-year. So the first -- as I mentioned, a significant amount of that net headwind of $170 million, $125 million to $135 million is happening in the first quarter. So that's a dramatic impact to the first quarter, which makes sense, given the timing of the headwinds last year.

Operator

Our next question comes from Jeffrey Sprague with Vertical Research Partners.

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

Jim, I was wondering if you could elaborate a little bit more on what the kind of other margin enhancement actions you are taking. I assume those are above and beyond the Q4 restructuring. And then also, just maybe as a follow-on to that last question. It would seem you would still expect actual adjusted EPS to probably be down on a year-over-year basis in the second quarter. Is that correct?

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

You take the second part.

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

Okay, yes. Yes it's not true, Jeff. We actually expect adjusted EPS to grow because we do have a low tax rate again in the second quarter, and we had one last year, so that's -- it's a bit of a headwind, but it's not a significant headwind. And we do expect OM dollars to grow year-over-year.

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

Okay. And on the margin enhancements, I'll give you a little appetizer. I think the main course, we'll serve up at the Analyst Meeting. But essentially, we've -- as soon as we completed the work in the fourth quarter on the cost takeout, the near-term cost takeout, we said to ourselves, "Our margins are under attack from these headwinds. We need to get back what we've lost already, so that $250 million will help. But what if we get more of the same? What if we, the down -- what if we go into a downturn in back half of '19 or in '20?" And so we said, "We really need to basically create some protection for, call them black swans or economic cyclical aspects." And also, our objective here is to grow our operating margins by 50 basis points a year. Obviously, that didn't happen in 2018, and we're committed to do that. So we need a way to get there. And we thought about this, and we said, "22/22, we're 2 years in. We've done enough deals now, and they're -- every one of them is a deal that we'd do over again if we could. We love these deals. We've done enough so that we can actually see our way pretty much to 22/22 from a revenue point of view. Now let's figure out how we can make sure that we get the margin to go with it to create operating leverage so that we really get that double benefit of lots of revenue growth and margin expansion at the same time." And so we've been working a lot on different elements of digital technology and how that can be used to create value in our company, both from a value proposition point of view, in our products, in our business models, but also in our functional processes and so on. And it really occurred to us that if we could accelerate many of these things that we're working on and put some serious, accelerated focus on them, that -- we started adding up the benefits from these various initiatives, like Industry 4.0, Advanced Analytics, Procurement 2.0 and indirect cost management, the technologies that exist today, to use analytics to really do those --and manage those various topics in a much more efficient manner is really compelling. And so we've been experimenting with some of that, and we feel confident now that we have something that can generate hundreds of millions of dollars of benefit over a 2- to 3-year period. And we'll figure out what the exact amount is, and we'll share that with you in May. But it's a very large number and it's a very focused initiative. We're going to run it like an acquisition integration, with governance. And like I said earlier, we're going to focus on executing the growth initiatives that we already have and we're going to focus on margin expansion. And I think the combination of those 2 things is going to be incredibly powerful.

Operator

Our next question comes from Julian Mitchell with Barclays.

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

Maybe just a quick update on what the sort of delta is in your earnings guidance versus previously the commentary around high single-digit growth. Is it simply about a point or so less volume growth assumption? Or was anything changed in terms of your confidence around pricing initiatives, particularly in Tools?

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

Yes, I would say that there's certainly a point difference in growth, as you mentioned, versus just looking at the markets as they play out in the fourth quarter, and the view of U.S. housing and the automotive space for production just feels like there's still growth there, but it's slowing. So that's certainly one factor. We do have a little bit bigger tax headwind as well because we did come in lower for 2018. So that's a little bit of a headwind in addition. And then the third thing is we need to continue to monitor the impact of all the price in the markets. And like we said in October, we're putting a fair amount of price actions into the market. We're going to manage this both looking at what's the right thing to do for price and what's the right action to ensure we have the right level of volume. And we're going to manage those in concert with each other to achieve the right outcomes. So as we continue to do that, there will be a little bit of pressure probably in the margin rate versus previous expectations, and we saw that play out in the fourth quarter. But those are really the 3 main factors.

Operator

Our next question comes from Michael Rehaut with JPMorgan.

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

Just a little bit more detail, if possible, around some of the moving pieces of '19 guidance. And obviously, appreciate all the help so far. First, on the margin -- I'm sorry, quarterly cadence, with the biggest hit of the commodity inflation being in the first quarter, are we to understand that the reason you have the confidence that you'll switch to operating margin positive in the remaining quarters is because of the cost actions that have already been put in place? Or is there some amount of price realization as well that you're still expecting? And secondly, also on the deleveraging, how are we to think of share buyback for '19 when you talk about the benefit that you expect from lower shares? Is that just that the flow-through from what you've done in '18? Or is there anything incremental in '19?

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

Yes. So the cadence of the quarter is clearly, the biggest impact in the second quarter is going to be the headwinds going down dramatically year-over-year as we begin to annualize those headwinds in the second quarter. If you remember, in 2018, we certainly vividly remember the timing of all this. But as we went into March and April, we began to see commodity prices increase. We got into May and we saw FX shift dramatically. And in then June, we saw tariffs come onto the scene. So in the second quarter, we saw significant ramp-up of the headwinds, and that continued into the third quarter. So as we get to the end of the second quarter and into July, we will have comped a lot of those headwinds. And so you look at that aspect and then you look at the impact of the cost reductions, which the impact is relatively even across the 4 quarters, and so it's about $60 million per year -- per quarter, I'm sorry. And therefore, you got that impact, combined with a lower level of headwinds year-over-year because of that comp issue is really why we believe we can grow our operating margin in the second quarter.

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

And also the fact that the pricing actions are kind of accumulating over time and getting bigger every quarter sequentially. And so that has a benefit, too, especially as we get into second quarter of 2019.

Operator

Our next question comes from Nigel Coe with Wolfe Research.

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

Just want to just unpackage your -- either for 4% to 6%, so let's call it 5% Tools & Storage growth in '19. Roughly, how does that shake out between North America, Europe, rest of the world? And what would your estimate be for market growth in North America in '19?

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

I think the actual range Don provided was probably 4% to 6%, so it was probably going to be a little bit on the -- more towards the high side of that. So I think that's what we're looking at for the -- over the course of '19. And I think you'll see that we're absolutely committed to growth in all markets. So you look at growth, we'll have growth in North America, we'll have growth in Europe, we'll have growth in the global emerging markets consistent with what we had this year. Of those 3, probably, the leading growth contender will be North America as it was in '18. But we're getting growth in both of those other places as well. And we think with that estimate, we'll grow above the market, therefore, representing market share gain again in 2019, consistent with what we had in '18.

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

Yes. And I think we all know that the European economy had slowed quite a bit. Germany went negative, the U.K. is in chaos and confusion with Brexit, Italy is a disaster. And despite all that, our European outlook for Tools is going to decent, it'll be probably 2% to 4% kind of growth. So it's still continuing to forge ahead in Europe. And then emerging markets, we have some specific markets that are challenged right now, as almost -- as we almost always do. I think in this case, Turkey is tough, Argentina is really difficult. And we had major currency devaluations in those markets, but also just the economies themselves are really difficult. So we might see a little bit slower growth in emerging markets this year than we did last year. But still, we're going to be significantly positive, and we'll be running at least 3 times higher than the overall market growth.

Operator

Our next question comes from Susan Maklari with Crédit Suisse.

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

I just wanted to get a little bit more color on what you're thinking in terms of some of the commodity inputs. We've seen some of those pull back in the later parts of 2018. What's embedded in the forecast from that perspective for 2019?

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

Yes. So I talked about net headwinds of $170 million. If you break that down a little bit, the gross headwind is about $320 million and you have an offsetting price impact of $150 million. Of that $320 million, approximately 1/2 of that is commodity inflation, so it's a significant number. We have seen positive trends around certain commodities, for sure. But we do have to remember that a lot of the commodities that we get are really engineering-grade commodities, and we haven't seen as much of a movement in those commodities versus some other more straightforward commodities, in steel in particular. So we've seen a little bit of benefit since December. And as we continue to look at this, it may continue to trend in the right direction, and it could result in an opportunity for us as the year goes on. But at this stage, we actually have not seen a dramatic movement in the commodities that we buy because we tend to buy at the higher end of the grades. And as a result, that hasn't moved as much as some of the other commodities. But the trends are positive, which we feel good about right now.

Operator

Our next question comes from Joshua Pokrzywinski with Morgan Stanley.

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

Just a question on the bridge. I know that there's kind of a lot of moving parts here, and maybe with the outstanding numbers from 3Q, could use a little bit of an update. I guess the real delta here would seem that a normal organic growth, if the right number is kind of a 20% incremental margin, you guys seem to be closer to 10%. And there looks like there's been, at least on the surface, some slippage in that $250 million of cost reduction, and a lot of that soaks up the relief that you've gotten on tariffs or baking in, less 3% to 10%. Is that kind of the rough math of it? Because, I guess, both of those numbers, both the headwind and the tailwind, seemed a little bit lower than what I would have thought on the surface just to start out.

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

Yes, I think on the leverage front, you probably have to really look at it on a volume basis versus total organic. So if you look at volume, you can use an assumption like 20%, 25%. That kind of gets you to the numbers that we're talking about. And then there's a separate price benefit that's netted in the headwinds that we've laid out for guidance and for actual results. Because we really dissected that because pricing can kind of mute the leverage numbers or change the leverage numbers quite a bit. And as a result, you're better off looking at them in those separate categories.

Operator

Our next question comes from Nicole DeBlase with Deutsche Bank.

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

So I guess just a couple. One is kind of a box-ticking item. On the margin enhancement initiatives, could that possibly give upside to second half with respect to payback? Or is that more of a 2020 payback? And then if you could just talk about the impact of what's going on at Sears on your Craftsman rollout expectations.

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

Okay. Well, it's Jim. I'll have Jeff handle the second question. And on the margin enhancement initiative, the benefit that we're going to see from that is going to be recognized over a 2- to 3-year period. We're going to do everything we can. We're going to work really hard to try to bring some benefit into 2019 as an insurance policy. And it's not clear that it's going to be a huge number. But I think it's -- there's probably something there, and we'll go after it.

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

Regarding the question relative to Sears. I think it's really, based on everything that has just occurred in the last 2 weeks, you'd say it's very much business as usual. If you look at the trend over the last, at least 36 months, that company would typically announce a closure plan following holiday sales, and that would be updated over the course of the year to include more and more stores. This year, it's not much different. So the fact that those stores will remain in operation at a lower count than the prior year, et cetera, is very consistent with what's happened in the prior years. So we expect that our Craftsman rollout will continue to take share as that presence atrophies in the marketplace. So not that different than any other prior year.

Operator

Our next question comes from Michael Wood with Nomura Instinet.

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

If we take into account Craftsman accretion to growth and what -- where we think you're running at for price, it seems like there's not much organic growth outside of Craftsman in Tools & Storage volumes. You seem to be tracking well above that currently, so I'm curious what is explaining the deceleration in that lack -- in the business ex Craftsman. And does that concern you?

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

Well, I think that we try to make it clear that the economic backdrop is one of slowing growth, it's nothing to do with our market share. Our market share continues to outperform the market. And I think the reality is setting in, hopefully not just us, but most industrial companies are facing slower economic growth in the United States, in China, in pretty much most parts of Europe and the emerging markets. I mean, essentially the whole world except for a few bright spots like India, for example. But the reality is that economic growth that we see for 2019, and -- is pretty -- is probably a good point lower than it has been in the recent couple of years. And then on top of that, it's no secret that the construction markets in the United States have slowed as well. So baked into our guidance is a reality check on the slowing markets. It's not catastrophic. It's nothing that we can't handle. But our long-term growth objectives are 4% to 6%. We're putting 4% out there at a time when economic growth is slowing. Makes perfect sense to me.

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

Yes. And at the end of the day, we think that's the right thing to do for all the reasons that Jim articulated. But any chance we're wrong, the markets are a little better, then we'll all be happy. But this is the right approach, given the signals that we've seen in housing, the signals that we've seen in the automotive production space. They're all showing growth for the most part except for auto production. Looks like it's going to be down next year. But they're slowing, and we have to be realistic about what the trends are right now.

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

Maybe one last addition would be if you look at 2018, our growth was 6% to 7% in Tools in a market that grew slower than that. That market, we think, is going to be compressed by about a point this coming year, and our growth looks pretty similar to that, 5% to 6%. So our growth rates will still be accretive to market growth although the market's growing just a little bit slower. That's kind of it.

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***

Just maybe following on that a little bit, Jim, and the slowing that you saw -- that you're expecting to see in the U.S. I mean, Tools & Storage still put up 10% organic in North America. And so can you talk about whether you started to see slowing in 4Q as the quarter progressed? And then I guess my second question for Don, in talking through that $250 million cost benefit number, did you recognize any of that in 2018? And what's the cadence of that number as we progress through 2019?

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

Okay. I'll take the first part. The slowing in the tools market, I think, started in the third quarter, concurrent with the interest rates increases that were being implemented by the Fed. And we saw the same thing in automotive as well, the interest rate sensitive type markets: housing, automotive, impacted by rising interest rates. And it continued in the fourth quarter. We were thinking, well, maybe it's an anomaly in the third quarter. Sometimes, you get those for a couple of months or a couple -- yes, a couple of months. And it really did continue into the fourth quarter, pretty steady in the sense that it didn't get worse, it's just kind of felt a little bit more anemic in the third quarter and fourth quarter than it did in the beginning -- of the first half of the year.

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

And on the cost takeout side, we did get a modest benefit in the fourth quarter just because some of them where implemented in the November time frame, but it wasn't significant. And the cadence is really, as I mentioned earlier, pretty equal across the year. So it's roughly $60 million to $65 million per quarter.

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

Maybe one other addition to what Jim just highlighted is that we said for '18, that North America outpaced Europe and global emerging markets. That is also true for '19. And in that, retail -- North American retail and North American commercial, therefore, will be accretive to the overall rates we just described. So it's very consistent with 2018.

Operator

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

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

I had a couple of questions, first being on channel inventories across your core end markets and your customers. Was there any pull-ahead risk, particularly in slowing traffic and some of these customers that we're seeing? Any potential pull-forward risk into the quarter from tariff-related price increases in your core Tools businesses?

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

Yes. I wouldn't say -- we don't really know if anybody pulled anything ahead for tariff reasons. So our customers don't necessarily tell us that they're doing those types of things. I would say that the inventory levels did modestly increase as we exited the year versus the previous year end, but frankly, they're not significant. It's not something that we view as a major concern as we go into the first quarter and the year.

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

Maybe additionally, the POS, as we exited the holiday season continued to be quite strong. So what Don described was we did have a little bit of inventory build in the course of the quarter. Most of that was gone by the end of the year, very, very consistent with where we wanted to be at the end of the year and where we ended last year. Secondly, in terms of pull-forwards, the retailers and so forth have gotten so sophisticated, system-driven, that there's very little pull-ahead these days when you announce pricing. So that was not a big impact to the quarter.

Operator

Our next question comes from Robert Barry with the Buckingham.

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

Just a couple of things. One is a follow-up on an earlier question on commodity. Did that headwind actually go up versus that 3Q? Because I thought it was $100 million. Now you said -- I think you said 50% of $320 million. And then on the tariffs. Is that now, in the walk, $100 million headwind? I'm just curious to the extent to which the change in the value of the renminbi might actually be able to help you offset that.

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

Yes, the commodity number has gone up primarily because of just some accounting dynamics on how certain things get accounted for. There's a number that's kind of hung up in inventory as we go into this year that will impact the numbers. So it's up by $40 million to $50 million versus maybe what we were thinking in the middle of last year primarily because of that dynamic. And the other thing is on the tariff side, yes, that number is correct, incremental $100 million year-over-year.

Operator

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

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

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

Operator

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