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SWK - Q2 2013 Stanley Black & Decker, Inc. Earnings Conference Call

EVENT DATE/TIME: JULY 26, 2013 / 12:00PM GMT

OVERVIEW:

SWK reported 2Q13 diluted GAAP EPS of $1.23 and diluted EPS of $1.21. Expects 2013 EPS to be $5.40-5.65.

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PRESENTATION

Operator

Welcome to the Q2 2013 Stanley Black & Decker, Inc. earnings conference call. My name is Christine and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please note that this conference is being recorded.

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

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

Thank you, Christine. Good morning, everyone, and thank you for joining us for Stanley Black & Decker's second-quarter 2013 conference call. On the call in addition to myself is John Lundgren, Chairman and CEO, Jim Loree, President and COO, and Don Allan, Senior Vice President and CFO. Our earnings release, which was issued earlier this morning, and a supplemental presentation, which we will refer to during the call, are available on the IR portion of our website, as well as on our iPhone and iPad apps. A replay of this morning's call will also be available beginning at 2.00 PM today. This replay number and the access code are in our press release. This morning, John, Jim and Don will review Stanley's 2013 second-quarter results and various other matters, followed by a Q&A session. Due to the size of the queue, we are going to stick with just one question per caller. And obviously please feel free to call me with any follow-up questions after today's call.

And, finally, 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 risks and uncertainty. It's therefore possible that actual results may differ materially 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 in our most recent '34 Act filing.

With that I'll now turn the call over to our Chairman and CEO, John Lundgren.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

Thanks, Greg, and good morning, everybody. Second-quarter highlights certainly included 12% revenue growth due to a combination of 5% organic growth, of which we were very pleased, and the other 7% the addition of Infastech. Diluted EPS of $1.21 a share was up 7%. And diluted GAAP EPS was actually $1.23. And the press release, if you've had a chance to look at it, explains, I would say, the counterintuitive nuance of GAAP earnings being higher due to the reversal of an accrual. And if anyone needs more information, Don can get you that off-line or during the Q&A.

The organic growth initiatives, which we've talked about on the last three calls, are accelerating particularly in the emerging markets. Our CDIY and Industrial businesses both had compelling top-line results, as well as margin growth. CDIY organic growth of 6% and an operating margin ex-charges of above 15%. And Engineered Fastening grew 9%. And that's well ahead of its core market, core automotive market, around the globe. And in the discussion of the segments, Jim will talk a little bit about the penetration, increased penetration and resulting share gains that we're experiencing in that business.

Security globally, organic revenue was down 1% due primarily to the Convergent Security Solutions volume declines in Europe. And that was partially offset by organic growth in both our commercial hardware and Access Technologies, or automatic doors business. The bright spot is orders increased significantly in both North America and Europe as the quarter wound down. And volume, Niscayah synergies and platform growth investments are expected to lead to margin recovery for Security in the second half. More about that at the end of our brief presentation from Don when he discusses the outlook. But as a consequence, we are maintaining full-year guidance. As our increased organic growth expectations, we expect to offset the significant headwinds that we are facing from foreign exchange in selected markets.

Looking briefly at the sources of growth, sequentially, volume, as mentioned, was up 6%. Price was down 1%, leading to, on a global basis, 5% organic growth. Acquisitions, primarily Infastech, added 7%. In the quarter the impact of FX was flat, leading to our 12% revenue growth versus 3% the same period a year ago. In the regions, we were quite encouraged. US in total up 6%, Europe 2%, the emerging markets 12%. And the rest of the world, the details of which are in the appendix but it's primarily Canada and Japan, were down low single digits, while Australia and New Zealand were flat. The rest of the world was down about 2% as a combined group of countries, for the total 5% in terms of organic growth.

So the momentum from our growth initiatives continues to build. And let me talk about those for just a second before we get into the segments. We have hired 450 people, feet on the street, primarily sales folks, primarily in emerging markets, to drive the growth that we've talked to you about on our last two or three calls. We've also completed the acquisition of GQ, the number three Chinese power tool company. A significant move for us in that it allows us to expand our mid-price point footprint in the Asian markets, in particular, emerging markets in general. And we remain on track to our three-year commitments from our Project Leapfrog, or our organic growth initiative, for $850 million of incremental revenue and $200 million of incremental operating margins. Again, as we've highlighted, this is something that we track rigorously, regularly, with the same, I'll say, intensity and metrics that we would track a large acquisition integration. So we feel, at this stage, quite comfortable with those numbers.

Looking at the emerging markets, and the impact the growth initiative has had, really strong quarter. Russia 31%, China 24%, Southeast Asia 13%, Middle East/Africa 15%, and Latin America up 15%. Very strong performance. And as a consequence, per the press release, we are now expecting those initiatives to contribute 2 percentage points, or 200 basis points, of incremental growth for the year, versus the 100 basis points, which was our previous forecast as these programs begin to gain traction and really put some points on the board.

Let me turn it over to Jim who's going to quickly walk you through some of the highlights from our three segments.

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

Okay. Thank you, John. Once again, CDIY had a terrific quarter. Strong execution across the globe, coupled with improving US residential construction and DIY markets produced excellent results. Revenues were $1.446 billion, up $115 million or 9%. Segment profit was $219 million, up $11 million or 5%. And organic growth was 6% in total, with professional power tools up 13%, the consumer products group up 3%, and hand tools and storage up 5%. The operating margin rate was 15.1%, down slightly, 50 basis points from a year ago, reflecting strong impact of the growth initiatives, as well as strong promotional activity in the US. Professional power tools benefited from a growth perspective from those promotions, as well as new product introductions and emerging market gains.

The Consumer group benefited from outdoor growth, which was a turnaround from the first quarter when we had some weather issues, a global steam product introduction, and strength in the emerging markets. And hand tools and storage experienced gains from the Black & Decker revenue synergies specifically associated with DeWalt, and the continued rollout of last year's program at STAFDA, as well as a major US home center. In addition, this quarter we began a rollout of DeWalt mechanics tools at a major US retailer. They accounted for most of the growth in hand tools and storage. And, in total, as we look at CDIY we conclude this business is really in great shape, as its US market is shoring up nicely, while Europe has stabilized. And the growth initiatives continue to drive emerging markets gains, despite somewhat slower markets there.

Turning to Industrial, they also had a solid quarter all around, with surging organic growth the new story. Revenues were up 28% or $178 million, aided by Infastech which added 21 points and 8% organic growth in total. Segment profit was $117 million, up $22 million or 25%. And organic growth was a great story across the businesses, with IAR up 4%, Engineered Fastening up 9%, and Infrastructure up 22%. The operating margin rate was down slightly 50 basis points, reflecting the growth investments and a slight mix down from Infastech. In Engineered Fastening, the automotive segment of Engineered Fastening was up 15%. And that outpaced a plus 1% global light vehicle production. And the Infastech integration is on track. And, in fact, their pro forma organic growth was 9%, as well. Industrial and automotive repair North America was up 2%, with Mac Tools strength, offsetting a very weak government business. And the growth initiatives gained traction, particularly in the emerging markets and in MRO vending.

And then the infrastructure business, which was up 22%, was really powered by the oil and gas business, or CRC Evans, which was up over 40% organically. And that was somewhat offset by weakness in the scrap steel market which affected our hydraulics tools business negatively. The story at oil and gas was the recovery of the North American onshore market which, as you know, for a year or two has been going in the opposite direction for us, and it really turned around. And we had seen that coming. In addition to that, we had strong offshore growth in connection with our organic growth initiatives. So surging growth in this segment driven by the growth initiatives and Engineered Fastening performance, all in all a great story, which we expect to continue into the second half.

Now moving to Security, it was a mixed picture, with organic growth in mechanical offset by continued Europe weakness, resulting in minus 1% organic growth overall and some margin compression. Revenues were $611 million, up $10 million or 2%. Segment profit was down $18 million or 23% to $61 million. And the organic growth story in North America for CSS was modestly positive at plus 1%. Europe was down 5% for CSS, and mechanical was up 4%. I think the bright spot, as John said -- and it's very encouraging for CSS -- was that the second-quarter order rates grew in North America and Europe by 7% and 11%, respectively. Yes, that's double-digit order growth in the second quarter in Europe. And the backlog in both cases grew significantly. And that's a direct result of the organic growth initiatives and the Niscayah integration success that is taking place.

The mechanical organic revenue was up 4% on commercial lock direct-to-distributor model successes. And increased automatic door installation activity at selected retailers. And I will say there's a wave of new product introduction coming in the second half for the mechanical business, which, when coupled with the distribution change and the move to independent distribution, should result in some very strong earnings and revenue growth. So, overall the 300 basis point margin decline in Security was driven by a number of factors -- the growth investments, some field cost inefficiency and preparation for increased growth in the second half, the European volume headwinds, and the impact of the temporary impact of the distributor model shift in the mechanical business. And that basically results from still having the same or similar costs to serve, that we had when we had a direct model, but taking a slightly lower gross margin in order to run through the distributor channel. And in the second half you'll see the cost to serve come down as the costs get taken out of the cost structure. And then MAS will restore its profitability to more historical levels.

So, all of the headwinds I just discussed are temporary in nature. And we expect the margin rates to bounce back nicely in the second half. You'll have significant benefits relating to the organic growth investments in both vertical market initiatives and the emerging markets. We will convert the growing order backlog, which will drive field efficiency, as well as revenue growth. We'll complete the mechanical model, go-to-market model transition. The volume will pick up. Some redundant costs will come out related to the cost to serve that I mentioned, and as we have now fully shifted to the new and direct distribution model. And then there'll be an increased level of Niscayah synergies as they get executed. And you'll recall that last quarter we upgraded our estimate from $35 million to $50 million for Niscayah synergies for the year. Most of that impact will be felt in the second half.

So these actions will drive operating margins to the mid teens levels in the second half of '13. The growth is coming and we feel very bullish about the second half for Security, as you can see. And at that point all three of our segments will be driving organic growth, earnings growth, and margin expansion.

With that I'll turn it over to Don Allan.

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

Thank you, Jim. I'd like to spend a little bit of time and talk about working capital on page 10. Our working capital turns improved from the prior year by approximately 0.3 turns. And sequentially from the first quarter by over 1 turn. Which allowed us to drive a significant cash flow benefit in the second quarter, which I'll touch on a few minutes. We're very focused on how the Stanley Fulfillment System continues to evolve and get implemented throughout our Company. We continue to see modest improvements in both accounts receivable and accounts payable, as we focus on the back-office operations and more efficiencies with our vendors and our customers, to drive working capital benefits.

But the more significant improvement continues to be the focus on inventory. Our inventory days went from 78 days in the second quarter of 2012 down to 72 days here in the second quarter of 2013. And that's an area that we've been focused on significantly for the last year or two. And we'll continue to be focused on as we believe there is more efficiency to be gained in inventory throughout our entire manufacturing and supply chain. The impacts of the Stanley Fulfillment System continue to be seen across our Company. And our working capital continues to become more efficient. The expectation for year-end 2013 is that we believe we can achieve eight working capital turns as we continue on our path towards 10 working capital turns by 2016 or 2017.

So let's move to free cash flow on the next page. Free cash flow, as I mentioned, was very strong in the second quarter, as we achieved a 117% conversion rate -- IE, free cash flow as a percentage of net income. This is obviously before special charges. But the result is really seen by strong earnings performance, as well as the strong working capital performance that allows us to drive that type of conversion rate in our Company. A couple items to mention on the free cash flow statement. The first of which is that if you look at the line called other/restructuring, we had some timing issues in the second quarter which caused a bit of a negative drag. And that has to do with such things as pension payments which occurred in the second quarter of this year. And occurred in different quarters in the prior year. Simply a timing issue that we believe neutralizes itself by the end of the year.

The other area to notice on the free cash flow statement is the cash outflow associated with working capital through the first six months. You can see it's quite significant. However, it is in line with historical trends. And as many of you know who follow our Company, we tend to see a very positive inflow of cash from working capital as the year progresses. And in particular as we get into the fourth quarter given the seasonality of many of our significant businesses. And as we achieve our eight working capital turns by the end of the year, we will see that number turn to a significant positive inflow. As a result, although our year-to-date free cash flow trails prior year at this point in time, we believe $1 billion of free cash flow is achievable due to the expected strong second-half earnings, which I'll touch on in a few minutes, combined with working capital turns improving to eight turns, and then some of these timing issues beginning to neutralize themselves by the end of the year.

So with that, I'd like to spend a few minutes and talk about our guidance. We are reiterating our 2013 outlook today. We expect our EPS to be in the range of $5.40 to $5.65. This would be 16% to 21% EPS growth versus 2012. The vast majority of our guidance items have remained unchanged since April. But there's two items of significance that we want to point out that has changed. The first of which is that we're raising our organic revenue guidance from 2% to 3% from our prior guidance, up to 4% to 5% growth versus 2012. This is going to drive approximately $0.20 accretion of EPS versus the prior guidance that was provided.

Let me give you a little more information in detail on that particular category. If you break it down into core organic growth versus the gross initiative, we expect the core growth to now be 2% to 3%, which will contribute $0.30 to $0.45 of EPS. That's up from our prior expectation of 1% to 2% organic growth. Additionally, as John mentioned, we believe organic growth initiatives will now yield 2 points of growth versus the previously communicated 1%. However, it still will be slightly dilutive for the year. It will be about 10% dilution versus our prior guidance of $0.15, as we continue to leverage through the effects of the investments during the year. And by the end of the year begin to see some accretion occur related to these growth investments.

The second offsetting item, that is offsetting this positive impact, is that we are seeing headwinds related to foreign currency. And we expect that to be approximately $0.20 of EPS of a negative in the second half of the year. Several countries have moved negatively versus the US dollar where we have a significant presence, such as Brazil, Argentina, Canada, Australia, Mexico and India. We continue to monitor that and are focused on what types of actions we can take to offset that impact, such as areas of customer pricing actions, et cetera. But it clearly appears to be a headwind of significance in the back half of the year. The net effect of this is obviously neutral, and it allows us to reiterate our guidance range, as previously communicated.

One other factor I'd like to mention is really the timing of the third quarter versus the fourth quarter associated with EPS. We anticipate the third quarter to approximate 42% of our second-half EPS. This is slightly lower than the 46% to 47% historical norm that you see looking out at the last four or five years. It's really being driven by two things. It's the expected sequential second-half Security profitability improvements that Jim touched on, as we see continued sequential improvement from Q2 to Q3. And then more sequential improvement from Q3 to Q4 related to profitability. As well as that particular segment turning to a revenue growth organically versus a slight revenue decline in the first half.

The second area is similar to what we discussed in April, is that we continue to see the acceleration and the benefits of our organic growth initiatives throughout the year. And the investments weighing that down in the first half beginning to turn neutral in the third quarter and slightly accretive in the fourth quarter. Those timing factors are resulting in this dynamic that I just described.

The last thing I'd like to touch on, on guidance, is just a little bit of view of these segments. On the CDIY side, our expectation is that we will see mid single-digit organic revenue growth for the entire year. So continued strength, similar to what we saw in the second quarter. The operating margin rate will increase year over year as we see the benefits of cost synergies. We do expect a slightly negative effect of the growth investments impacting the operating margin rate, and offsetting some of the incremental profit or leverage that we see from the volume.

In the Securities segment, low single-digit organic growth is expected, as Jim touched on. We believe, based on the order trends and the backlog that's been created here in the first half of the year, that the North American business will begin to show more significant growth beyond current levels. However, that will be slightly offset by a continued low single-digit decline in Europe as that European environment continues to be a difficult environment, particular for our security business. The operating margin rate will decrease year over year, primarily due to the factors that impacted us here in the first half. But by the end of the year this business will be back approaching historical levels in the second half in the mid teens, as Jim discussed.

The Industrial business will see mid single-digit organic revenue growth for 2013. And the operating margin will decrease slightly, due, really, primarily to the effects of the lower than line average Infastech margins as they are in the early stages of the integration, as well as the impact of the growth investments. This allows us to reiterate our guidance of $5.40 to $5.65, as well as our free cash flow guidance of approximately $1 billion.

So to summarize the presentation portion of the call this morning, we believe we've made excellent progress with the growth initiatives. We're seeing sequential improvement that is being realized, which allows us to raise our guidance estimate in this particular area. The CDIY business, as Jim touched on, is really performing very well, driving significant organic growth through new product introduction, market share gains, and solid returns in the emerging markets, primarily from our growth initiatives. Industrial delivering strong organic growth, as well. And the Infastech integration continues to progress on track.

We're focused on our Security business continuing to improve, and showing more significant returns in the back half of the year, as we drive that backlog that we touched on, the benefits from the growth initiatives, continue the integration of Niscayah, to really ensure that our second-half performance gets closer to historical levels for this particular segment. The Company remains focused on driving organic growth, and really trying to maximize the synergies across all our businesses that are being impacted by integrations today. As well as we're focused on allocating capital that really provides excellent returns for our shareholders in the mid term as well as the long term.

That concludes the presentation portion of the call and we'll turn it over to Q&A.

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

Great. Thanks, Don. Christine, we can now open the call to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jason Feldman, UBS.

Jason Feldman - *UBS - Analyst*

Nice to see, obviously, that the organic growth initiatives are gaining momentum more quickly than expected. How do you think about that in relation to the three-year targets that you'd laid out, the $850 million contribution? Is this a pull forward, and then maybe the incremental pickup in the other years won't be quite as high, we're just getting it sooner? Or is it that the opportunity is really larger than you originally thought?

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

Jason, it's John. Good morning. Per my comments early in the presentation, at this stage it is the former of your two hypotheses -- specifically, a pull forward. It's very early days. And as we've quantified the entire basket of synergies, we're encouraged we're ahead as opposed to behind schedule. That being said, we just don't have enough information to suggest that it's a larger pot of gold at the end of the rainbow. Do rest assured, a year from now, if we think that's the case, as we did with Black & Decker synergies, when we realized it was more than just a pull forward on the cost synergies, we raised our estimate and raised the guidance. Far too early to do that because we've got nothing to tell us that the totality of these programs is any greater than what we initially thought about.

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

This is Jim. I would just add to that, that when we set forth on this initiative, the idea was to change the culture of the Company so that it could be capable of generating 4% to 6% organic growth annually. And it was a three-year commitment that we made and it was a finite commitment. However, we also indicated that we were hopeful that we would be able to direct the Company in a way that would yield a 4% to 6% minimum growth rate on an ongoing basis regardless of the economic environment. And this is where I think this progress that we made is very encouraging, because it seems like, while even if this is just an acceleration, when we get to three years from now, there'll be more acceleration. So the point is that it's a very encouraging indication that this Company is capable of driving growth while remaining financially disciplined. And driving margins as well. So we're excited about the progress. Obviously not going to commit to anything more on a three-year basis at this point, but it is a very positive start.

Operator

Rich Kwas, Wells Fargo Securities.

Rich Kwas - *Wells Fargo Securities - Analyst*

I had a question on Security with the European order growth in the quarter. That was a very strong number. And just wanted to get some additional color on what you saw in the quarter. I imagine the construction markets over there are not great. So how much of this was just growth with existing customers, new product, market share gains? Any color along those lines would be helpful. Thanks.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

All of the above. Jim will give you as much detail as we're comfortable giving you, Rich, at this stage.

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

It's early days in Niscayah. When we tackled this acquisition, we learned that Niscayah really didn't have a very robust sales generation capability. And, in fact, it was a symbiotic relationship between Securitas and Niscayah in the sense that Securitas, being primarily more focused on guarding, often would have customers that it would then hand off to Niscayah as a freebie, or maybe for a commission, or that type of thing. As Securitas and we have gone our separate ways post acquisition, we found out that we really needed to build -- not rebuild but to build -- sales generation capability. And I would say that's the single most important factor going on here, is that we've been hiring a lot of sales reps. And they've begun to produce orders, which is now hopefully going to be translated into sales at some point. And that's encouraging. But it's really that dynamic that is going on. And so, for the first year, year and a half or so we were experiencing negative growth that I would attribute largely to the economy, it was also due to the fact that we no longer had these sales hand-offs from Securitas. And now we have begun to rebuild our own sales force. I'd say that's the single biggest item there.

Operator

Nigel Coe, Morgan Stanley.

Unidentified Participant - - *Analyst*

It's actually Mike sitting in for Nigel. I was hoping to dig more into pricing. I was wondering if you can comment briefly on the price environment overall. And then specifically on, in the US, in CDIY -- just in CDIY where you lost 2 points from pricing this quarter. And then separately on the Security side, whether the increase in orders was due to maybe some give on pricing. Thanks.

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

Mike, it's Don. I'll give you a little bit more color on that topic, in particular. In CDIY in the second quarter we did have a fair amount of promotional activity, which was planned and expected. And so that's driving a little bit of that price impact. It's probably unusually high compared to previous quarters and future quarters because of that factor. The other thing to keep in mind, and we all know this over the long-term, is that that pricing number is more of an accounting number and doesn't necessarily capture the true effect of pricing impacts across the board. As we roll out new products at different price points, that price increase versus a previous product that it's replacing does not get captured in that line. We know in that particular business it's not exactly a full encompassing view. So those two factors together really are driving that impact. So I don't view it as a significant trend or change in the business. I think it's more related to certain promotional activities that we did in the second quarter that were expected and planned.

In the Security side of our Company, Security is an area that pricing -- it is a price-sensitive business. But you really drive value through the differentiation of service, as well as the differentiation of bundling the different products that you have, and trying to install and enhance the solution to our customers. And that's how you really drive positive price value. I think over the long term it's a business that you can drive positive price. And we have demonstrated this in this particular business over the past several years, that it is a business that allows that type of pricing situation. The current market in Security is there's nothing unusual happening about around pricing, specifically. I think it's pretty much in line with typical trends. And nothing has shifted or no dynamic is happening that's unusual at this stage.

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

In fact, a couple quarters ago we indicated that we thought that maybe we had been getting a little more aggressive on price, and taking some business that we perhaps, in retrospect, would not have wanted to take in the CSS North America business. Don and I have both spent a fair amount of time with the Security team going through their pricing, their price discipline, going through their backlog, and looking at the profitability of the backlog. And I can tell you that it is improving. And the new business largely being driven by the vertical market initiative and from the organic growth initiative. The vertical market initiative is where we have put together the bundles and the value propositions that Don is referring to. And, in fact, what we're finding out in a lot of these orders, and the order book in general, from the vertical market initiative is that the gross margins are coming in at somewhat above line average. And that is where we want it to be because we think the value that we generate in these verticals is very high, and therefore we should get paid for it.

Operator

Sam Darkatsh, Raymond James.

Sam Darkatsh - *Raymond James & Associates - Analyst*

Jim, the oil and gas strength, I understand it's off of a relatively small base. I think you also had some organizational changes within the CRC business. But the growth seems to be a real outlier, particularly based on what broad trends would be in the line pipe industry in the US. How sustainable are those growth rates? And how should we be looking at that going forward?

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

We've had some tough experience in the onshore North America over the last few years, which have made the comps relatively easy. So I do think we have a couple of easy comps in front of us. However, I wouldn't be looking for plus 40% every quarter. That said, the pipeline construction activity in North America is really almost back at the level it was about four years ago when it peaked. And we can see that. We've been talking for a couple quarters about the strengthening market. But it took a couple quarters for us to actually go from doing the proposals and so forth to actually doing the work, which is when we are able to recognize the revenue. So we see -- this is a long-cycle business. We have good visibility forward in North America onshore, and we see a continued strong market. Not greater than 40% growth but certainly very robust. And as far as the offshore business goes, which is the other half of the puzzle, that is extremely strong worldwide. And we expect that to continue, as well. So this should be a good growth driver for us for several quarters, if not years to come.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

Jim, let me just add to that because the format won't allow a follow-up. You'll recall when we bought this business about three years ago, it's new in terms of the business model, relatively new to Stanley Black & Decker. And to Jim's point, these are generally very large orders, they're very lumpy. And it's a huge difference on a $300 million revenue base if something comes in in the second quarter versus the third quarter. So even at the beginning of our ownership of this Company, it's a very lumpy business, is maybe the best way to describe it. And I think for your purposes and objectives, and ours as well, looking at rolling 12 months, or rolling 8 quarters, looking at things that way, as opposed to just the much more classic VP-wise, because of seasonality and things of that nature, is a better way to look at this business. And that's how Don's team looks at it as we try to get a better grip on it and how best to forecast. At the end of the day, though, it's going to be lumpy. If you do $320 million in a year, it's not going to be $80 million a quarter. It's going to be $60 million one quarter and $100 million the next. And that's just something we've learned to live with, with this business. Your question is very fair but just recognize that's a dynamic, I would say, unique to the oil and gas business.

Operator

Mike Wood, Macquarie.

Mike Wood - *Macquarie Research Equities - Analyst*

Impressive growth with your growth initiatives. I'm curious at the early stages what you're seeing in terms of the competitor responses from the market share gains that you're getting in these countries.

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

We're not seeing much yet. Power tools in the emerging markets are very hotly contested by our biggest competitors anyway. So, in some ways, I would argue that we're a little bit later to the game than some of them. However, we haven't really seen any major competitive response. I think it's really too early for that. And there were a lot of people betting against whether these initiatives would even be successful. And I suspect that competitive reaction will come once the success has been institutionalized.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

Mike, it would be naive for us to think, for we, Stanley Black & Decker, to think that as the share gains start to register -- remember, we're seeing them first in our shipments and in the POS. Competitors will see them three to six months later as they evaluate our performance versus theirs and others. It would simply being naive and irresponsible of us not to expect reaction because no one relinquishes share willingly. This is the power tools business. It's the tools business in general, and the power tools business in particular. We've been in it for 100 years. But that would be our expectation.

Operator

Stephen Kim, Barclays.

Unidentified Participant - - *Analyst*

It's actually John filling in for Steve today. Just wanted to get a bit more granularity on the FX headwinds outlook. It seems like the currencies you've cited are pretty contained, like 25% of sales. So I thought it was a little big, 2%, $0.20 just in the back half of the year. So what is your outlook for the back half in those currencies?

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

Yes. We basically have taken the rates of about a week, week and a half ago or so, and are using them as, really, our forecast for the back half of the year. We don't tend to try to forecast trending where they're going to go, up or down. As far as the magnitude of the number, you have to remember that in particular, Brazil and Canada and Australia are pretty sizable businesses for us and make up a significant amount of revenue. The other thing to factor in is it's not just translational FX, it's transactional FX. Which means we're shipping products into those countries, in many cases, from the United States or European markets. And so the cross currency exchange has a negative impact as a result.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

It's about 50-50.

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

It ends up being about 50-50. Exactly, John. So those are really the main drivers. But the transactional piece is why it ends up being bigger than anticipated. And part of that is hedged, but we don't hedge 100% of those types of activities because of the costs associated with hedging.

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

And the Latin American moves were very sudden and sharp, so they're big moves.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

John, you referenced 25%. That's roughly the percentage of our business in Western Europe. And obviously, the pound sterling and Euro is all that matters to us there. 50% of our business is outside the US. And there are very few currencies in the back half of the year strengthening relative to the dollar. So I think Don gave you some pretty good granularity there. And hopefully that will help understand and validate the magnitude of the headwind.

Operator

Michael Rehaut, JPMorgan.

Will Wong - *JPMorgan - Analyst*

It's actually Will Wong on for Mike. Can you talk about the trends in Latin America, especially in Brazil, as it relates to the consumer? There were some challenges in 1Q. So just wondering what type of impact you would expect to your organic sales growth initiatives as consumer trends and the political environments in these countries deteriorate current levels.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

Rank has its privileges so I'm going to delegate that to Jim, because if he can predict what's going to happen in Brazil quarter to quarter he's a better man than I. But we did have -- your point's very well taken in that we really were stunned by the difficulty in Brazil in the first quarter. It was a lot more friendly market in the second quarter. But Jim's been close to that. And give it a whack, Jim.

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

Brazil consumer market, definitely a little slower than it has been. However, all these markets in Latin America are just exceptionally volatile. And they bounce around from -- the markets themselves and the demand bounces around from quarter to quarter. And then the currencies bounce around from quarter to quarter. So your pricing positioning in the market changes dramatically over time. And in addition to that, there's some countries that have major political structural processes that drive further inefficiencies in the demand profile and supply and demand. So, it's hard to predict anything in Latin America, other than just go there and execute as hard and as fast as you can. And that's where adding salespeople, bringing new products that are more appropriately designed for the mid-price point segment, and so forth, enable us to achieve growth rates that are definitely above market growth rates. And that's what we've been doing in Latin America for a long time, because that's where we really, this formula that we are now applying to all of the emerging markets, has been applied for the last 10 years by the management team that is now running the overall emerging markets initiative. They're finding, actually, that some of these other markets around the world are more stable than Latin America, and, therefore, sometimes easier to penetrate than, perhaps, Latin America.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

Just to follow up, Jim made a very important point, and it's probably not news to most people. But unlike several North American-based, or US multi-nationals operating in foreign markets, particularly Latin America, I think it's really important to point out our entire emerging markets group, in general, and the Latin American group, in particular, is staffed by foreign nationals who have grown up in, lived in those markets, that are well-tenured executives within our Company. I spent half of my business career living and working abroad. And the value added by people who understand our Company and our Company's culture, values, codes of conduct, everything else, at the same time understand the markets, the people, the culture and, quite frankly, are quite accustomed to dealing with the day-to-day, week-to-week, month-to-month volatility and frustrations that Jim, I think, very adequately described, is a huge advantage. So it's just a point that I thought worth making on our emerging market scene. They are tenured professionals with local experience, that we're leveraging across the world. And I truly believe it's a competitive advantage, and I just wanted to make that point.

Operator

Peter Lisnic, Robert Baird.

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

This is Josh Chan filling in for Pete. You talked about how the order growth accelerated in CSS Europe. But North America also accelerated quite a bit. So could you talk a little bit about what you saw there?

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

Yes. I was referring earlier to these vertical market initiatives. They're part of the corporate organic growth initiative that we funded specially, and announced a while ago last July. And we've been working on these growth initiatives in Security in the vertical markets for about a year now. And what they involve is taking certain markets, such as financial services, education, K-12 and secondary education separately, healthcare, retail, and so forth, and putting together solutions for the customers using some of the proprietary technology that we've acquired over time. Such as our GLS technology, real-time locating and sensing technology, that would be, and the EyeLock technology, which is Iris identification. And putting together solutions that are specifically designed for applications within these vertical markets.

So, for example, in a K-12 environment, having the ability to lock down the school using this type of technology, or to identify potential intruders. To integrate the mechanical locking systems with electro-mechanical locking systems and electronic systems. All these types of things are relevant to the end customers. We have a demonstration center in Indianapolis where we have all these different solutions identified. And we bring customers in and so on. And the sales force has now been organized so that we have a segment of the sales force that's specialized to each one these verticals. And that's what's gaining momentum right now. And in addition to, I'd say, just decent execution in the rest of the market, that's what's providing the extra oomph for the growth.

And we've seen on a monthly basis that order rate is increasing on a sequential basis, and really beginning to grow like a wave of new business. And some of it is medium-cycle, long-cycle business, so it takes a while. But we will see that come to fruition in the second half in North America. And in Europe, we think, to some extent. Not as much. Because the vertical market solutions that I'm talking about are primarily, I'd say almost exclusively, focused on the North American markets right now. We're still in the process of integrating Niscayah. And when we get to the point that the Niscayah organization is ready in Europe, these solutions are exportable to Europe, and we will do that at that time. So they will provide future growth in Europe. None of that's really baked into the long-term guidance that we've given. However, that's the reason that you start to see North America order rates pickup in Security.

Operator

Eric Bosshard, Cleveland Research.

Eric Bosshard - *Cleveland Research Company - Analyst*

Question for you on CDIY. Nice acceleration of growth in 2Q versus 1Q. Just wondering if you can dig in a little bit more to the 2Q growth. You talked about promotions and some new products, and I'm assuming some of the outdoor move from 1Q to 2Q. So, wondering if you can break up the 6% into some of the components of that. And then how you think about the core and the benefit from some of the efforts in the second half for the 5% or better growth you're talking about in the second half.

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

Sure, Eric. Everything you said, Eric, is correct in terms of our outdoor moves, promotions. You'll recall Jim mentioned some major mechanics tools and hand tools moves. But Don can give you even a little more granularity, to the extent we're comfortable.

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

Sure. As Jim touched on, in the second quarter the growth was significant, really in almost all the areas of the business, both geographically and across what we call the SBUs. There was a promotional aspect in the second quarter, where in the prior year that occurred in the first quarter. So that was a factor. We did have the shift of the outdoor season from Q1 to Q2. And that will continue to shift into Q3 as the season ends roughly in a month or so. So those are all factors. But the reality is, what you see with these businesses that the new product introductions that they keep rolling out continue to drive organic growth and gain share. The emerging market growth through the organic growth initiatives are accelerating. So we have mid teens growth, or 15%, in emerging markets in the second quarter, that we expect to continue into the back half.

And then we don't talk a lot about Europe but, frankly, the European performance is very strong for them, where they had a relatively flat performance in a very difficult market. And that's allowing us to demonstrate all the other growth that we're seeing and have it flow through across the entire global business of CDIY. And that European flat performance is really because of share gains, as well as some new product introductions that helped facilitate that, primarily in the UK and in the Nordic region. So, all those factors together are the result of what happened in the second quarter, as Jim articulated. But the reality is, we see those trends continuing in the back half. And the growth that they experienced of roughly 6% is expected to continue in the back half of the year because of all the factors I just mentioned.

Operator

Liam Burke, Janney Capital Markets.

Liam Burke - *Janney Capital Markets - Analyst*

You had a very strong quarter on Industrial, of particular, IAR. Could you give us a little color on where in emerging markets you're gaining traction? It seems to be in addition to the strength of the Mac business scenario that's doing pretty well.

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

Sure. We had 4% growth in IAR, and we had double-digit growth in the emerging markets. So that was a good -- one of the big forces behind the growth, as you point out. First of all, the answer to your question is very simply that the emerging market growth initiative is what's driving that double-digit growth in the emerging markets. But more specifically, we're very fortunate because we are the only tool company that has both construction DIY strength in the emerging markets, as well as industrial and automotive repair access to those markets, channel access. So, the way we're going about this is, as opposed to coming at it from one perspective or the other, we're coming at it, we've joined forces internally between our construction and DIY business and our IAR business. And that has actually given as much better access to, I think, the IAR channels than we otherwise would have. Because what happens in many of these emerging markets is that the channels are very blurred in between construction DIY and industrial. You don't have, in many of these markets you don't have the highly developed channels that distinguish between construction, two-step, large retail, industrial channel, automotive repair channel. You don't have that in the emerging markets. You have much more chaotic channels, much less well-developed channels. And our ability to come at it from a joint perspective and cooperate internally between our construction DIY business and our IAR business I think gives us the ability to drive that growth the way I just described.

Operator

Dennis McGill, Zelman & Associates.

Dennis McGill - *Zelman & Associates - Analyst*

I think this question maybe is for Jim. But is there a way to take the backlog, both across electronic and mechanical, and just think about Security backlog overall, and have one number as far as what you're entering third quarter with, as far as thick growth year over year? And then within that, Jim, is there a way to separate out what you're seeing market-wise on the security or non-residential side from what your internal initiatives are? Are there signs, in your opinion, that you're starting to see the market actually pick up and get into a cyclical recovery?

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

Dennis, it's John. Jim will take it but just one point. We've made this many times but I think it's important to make it again, on backlog. Whether it's one number or two, what's more important is when it's executable or convertible. As we've increased our sophistication with architectural specifiers and things of that nature, we could have an order in the system that can't be executed until 12 to 15 months from now. Because if you think about new construction, we're at the very end of the process. As the building's being finished, is when wires are being laid or our systems are being put in. So whether you have one number or two, it's not possible for us. And as a consequence I guarantee it's not possible for you to take that and have it be of much value to you in terms of the next quarter or quarter after that. I just think it's important to make that point. But Jim can give you a little more detail.

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

I would only have made two points and that is definitely one of them, which is that the mechanical part of the business and, frankly, the electronic, are both at the tail end of the process. The second one is that, without question, there is an increase in the level of non-resi construction activity and increasing backlog related to that in the Security business. That is a piece of the puzzle. It's a much bigger piece of the puzzle in the mechanical business manage than it is in the electronic business. But it is, in fact, true that the non-resi construction market is picking up steam and therefore affecting both these businesses.

Operator

Dan Oppenheimer, Credit Suisse.

Dan Oppenheim - *Credit Suisse - Analyst*

I was wondering, John, you had talked in the past a lot about the goals of getting to 20% in terms of emerging market exposure, now getting awfully close to that. Given the different growth rates in terms of the markets, though, this may be, it's always a moving target. As you think about this, where do you now think of it in terms of what your goal would be for emerging market exposure?

John Lundgren - *Stanley Black & Decker, Inc. - Chairman and CEO*

It doesn't matter if you directed it to me or Don, our goals are unchanged. And, as we would have a tendency to do, when and if it looks like we're going to achieve it, and it's adding value to our shareholders, we'll raise that bar. But your point is correct. The combination of divestiture of HHI, acquisition of Infastech, and good growth, we've gone from 10% or 11% up to 16% or 17%, depending on the quarter, on an annual basis. We closed the year at about 16%. So we're getting there quickly. As we start to approach it, that 20% could well become 25% if those markets remain as profitable as they are now. It's incredibly important not just to grow but to grow profitably. And as Don and Jim have pointed out in various conversations, these markets are at or above line average, in many cases, which is not the case for a lot of businesses. So 20% could well become 25%. But let's get 20% in the bank before we change that goal. So what we talked to you and the investment community about in May, those goals are all unchanged.

Operator

David MacGregor, Longbow Research.

David MacGregor - *Longbow Research - Analyst*

Just on the Security business, encouraging to see the order outlook building. But wonder if you could just help us by elaborating on that 310 basis point margin decline. You had parsed out four different drivers in your presentation, Jim. And I was just wondering if I could get you to elaborate on that and maybe quantify the contribution to that 310 basis points.

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

There's not much more I can elaborate other than to say that, if you take those four items, they really do account for the vast majority of the 300 basis points. And they are all significant. I could say they are roughly 25% apiece or whatever. That's directionally accurate. They are all within 20% to 30%. Or each one is within 20% to 30%, I should say.

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

Christine, I believe that's all the time we have for questions. And we'd like to thank everyone again for calling in this morning. I know certain of you weren't able to ask a question. Please give me a call after the call and we'll be able to handle and accommodate any questions you have. And thank you all for your attendance and participation this morning.

Operator

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