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PRESENTATION

Operator

Welcome to the Third Quarter 2019 Stanley Black & Decker Earnings Conference Call. My name is Shannon, and I'll 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 M. Lange *Stanley Black & Decker, Inc. - VP of IR*

Thank you, Shannon.

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

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

This morning, Jim, Don and Jeff will review our third quarter 2019 results and various other matters followed by a Q&A session. (Operator Instructions) 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 in 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. Thank you for joining us.

As you saw from this morning's release, we delivered a strong third quarter, successfully overcoming \$90 million of currency and



tariff-related pressures as well as weak end markets conditions in some industrial and emerging markets. Fortunately, the U.S. construction and DIY markets continue to be supportive.

With the help of our growth catalysts, we once again achieved above-market organic revenue growth and, at the same time, protected our earnings base. Revenues were \$3.6 billion, up 4% with organic growth of 4% and acquisitions adding 3 points. That solid organic and inorganic growth was partially offset by a 2% decline from currency and 1 point from divestitures.

Tools & Storage achieved strong 5% organic growth with Craftsman, new product introductions and e-commerce contributing. North American retail POS continued at strong double-digit levels with the second week of October marking the 22nd consecutive week in double-digit territory.

Industrial total revenues grew 13% with a 16-point contribution from the IES Attachments acquisition. The IES integration and targeted cost synergies remain on track. Segment organic volume was down modestly 2% as global light vehicle production continues to be in deep contraction and general industrial markets are on a slowing trend across the globe. Currency also shaved 1 point off the Industrial revenue line.

Security made progress on its value creation plan, reaching an important milestone in 3Q with the generation of positive organic growth. Our investment in digital talent, the rapid commercialization of new technology-based solutions and our activities in the small and medium business segment are starting to gain momentum. Electronic security achieved mid-teens order rates during the quarter and is now working to convert a strong backlog into future revenue. We are confident that there is a significant value creation opportunity on the horizon as we execute this transformation. In this regard, we reiterate our commitment to update investors on our Security portfolio review no later than the first half 2020.

For the overall company, we delivered 2% adjusted EPS expansion and a consistent operating margin rate versus prior year. 2% EPS expansion, a seemingly modest accomplishment but impressive when taken in the context of \$90 million of external headwinds. It was our pricing, cost control and margin resiliency actions that enabled us to overcome an escalating tariff regime, persistent dollar strength and the unfavorable impact of which grew by \$15 million as the quarter proceeded.

As we look ahead to the fourth quarter and the year 2020, our view now assumes a continuation of the current demand environment across our markets as well as some carryover tariff- and currency-related headwinds into 2020. We continue to swiftly respond to the volatile external environment with price recovery, supply chain adjustments and acceleration of our margin resiliency initiative. It's a testament to the strength of our team and our enterprise that we have produced above-market organic growth and a 9% CAGR EPS expansion over the past 3 years while simultaneously absorbing \$900 million in commodity-, tariff- and currency-related cost inflation.

To preserve our ability to deliver continued earnings and cash flow growth in 2020 and beyond, we are taking new cost reduction measures that will result in approximately \$200 million of annualized savings. This is in addition to the previously announced margin resiliency actions which will also contribute materially to 2020. When taken in combination with our robust growth pipeline, these cost/margin actions position us for a solid 2020 setup for EPS and cash flow. So with that and with our balance sheet in great shape after deleveraging this year, we are ready to tackle whatever market conditions come our way in 2020 and beyond.

Here are some specifics which will continue to drive growth as we look ahead. The Craftsman brand rollout continues to be a fantastic story. By the end of the year, we will have grown Craftsman into a \$600 million business, net of cannibalization, just 3 years following the acquisition. That is \$500 million of pure organic growth. The Craftsman program includes several top-tier retail partners. And by year-end 2020, we'll have over 10,000 retail outlets with \$1 billion of revenue by 2021, 6 years ahead of our original plans.

It's also clear that our innovation machine is stronger than ever. FLEXVOLT is now nearing \$400 million in annual revenue and continues its double-digit growth trajectory. Our latest breakthrough innovations, DEWALT, Atomic and Xtreme power tools, offer the highest power-to-weight ratios available in the market, this time in the compact and subcompact segments. These 2 product lines are quickly adding hundreds of millions of dollars of growth, and the positive end user reception demonstrates that these products are going to be winners in the marketplace.

E-commerce is also a powerful growth driver in our emerging markets and developed markets. We are the industry leader by a wide margin with \$1 billion in global revenue, growing consistently at double-digit levels.

And then there are the revenue synergies from our recent acquisitions. We're well on our way to broaden our distribution of the Irwin and Lenox brands around the world, and by next year, we expect to generate a cumulative \$100 million to \$150 million in revenue synergies. Additionally, we are exploiting the revenue potential from the IES Attachments and Nelson Fastener acquisitions.

And then finally, with our MTD partnership, our teams are now working together on multiple opportunities to generate operational efficiency and revenue growth. With this relationship, we've gained entry into the \$20 billion lawn and garden market in a financially prudent way. And beginning in July 2021, we have the option to purchase the remaining 80% of the business with the potential to add approximately \$3 billion of revenue and an EBITDA multiple in the range of 7 to 8x.

These programs position us for a strong, multiyear revenue growth and share gain outlook. However, we are not singularly focused on growth. To support margin expansion and create a buffer for future external volatility, we're making progress with our margin resiliency program. This is a major transformational initiative which will provide \$300 million to \$500 million of cumulative operating margin benefit by 2022. Most of the benefit derives from systematically applying digital technologies, such as AI, machine learning, advanced analytics, robotics and connected factories, among others, to create value across our entire enterprise.

So as you can see, there is a lot to be excited about as we look ahead. As we make cost structure adjustments in the near term, we continue to feed the commercial and innovation machine that has created this powerful growth story.

So thank you. And now I'll turn it over to Don Allan, who'll walk you through in more detail on segment performance, overall financial results and 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 third quarter.

Tools & Storage delivered 4% revenue growth with a strong 5% organic growth, offset by 1 point of currency. Volume growth contributed 4 points and price delivered 1 point of growth.

The operating margin rate was 16.6%, flat versus the third quarter of 2018 as benefits of volume leverage, pricing and cost control were offset by the impacts from currency and tariffs, which totaled approximately \$90 million for the entire company. However, 95% of that impact was in Tools & Storage. Share gains were experienced across each Tools & Storage region and SBU.

Looking at the geographies. North America was up 7% organically. U.S. retail had strong momentum and delivered low double-digit growth in the quarter. The U.S. commercial channel posted low single-digit growth while the Industrial Tools & Storage business was down mid-single digits due to the ongoing customer inventory corrections we've been experiencing. And then the automotive repair channel had growth of low single digits.

The strong quarter in North America was fueled by our growth catalysts, namely the Craftsman brand rollout and an ongoing stream of new core and breakthrough innovations such as DEWALT, FLEXVOLT, Atomic and Xtreme. The shipments were supported by continued strong sell-through, as evidenced by the double-digit POS growth in North American retail. The growth catalysts have been a steady source of outperformance, which has helped us to navigate slower growth in industrials -- in the industrial and emerging markets.

Now moving on to Europe. Europe delivered 4% organic growth in the quarter. This was led by the U.K., the Nordics, Central Europe, Greece and Iberia, more than offsetting some softer markets, including Germany and France. Overall, the team continued to gain share, leveraging new product innovations and commercial actions to produce above-market organic growth. This will be the sixth year in a row that our European team has demonstrated mid-single or high-digit organic growth, a truly outstanding performance by that team.

Finally, emerging markets declined 1%. The ongoing benefits from price, new product launches and e-commerce expansion were more than offset by market contractions in Mexico, Turkey and China. We continue to see share gains across the region with Brazil, Chile, India, Taiwan and Korea posting mid- to high single-digit growth and then Russia delivering double-digit growth in the quarter. The emerging markets team continues to contend with currency volatility and is delivering pricing actions to protect our margins and leveraging our growth catalysts to deliver share gains.

Now looking at the Tools & Storage SBUs. Power Tools & Equipment delivered 6% organic growth, benefiting from commercial execution and new product introductions. We are benefiting from the strong Craftsman performance as well as expanding our leading DEWALT power tools system with new innovations. Our trio of breakthrough innovations, FLEXVOLT, Atomic and Xtreme, delivered on key user needs for more power with smaller formats. They clearly are generating share gain for us and our customers.

Moving to Hand Tools, Accessories & Storage. We delivered 5% organic growth driven by new product introductions and the ongoing Craftsman rollout. Our national big-box partner is now fully set across all locations with the successful launch of 1,200 new Craftsman products. The broader rollout for our e-commerce and other retail partners is well under way. Sell-through remains strong, and we continue to convert new users, which will represent significant share gain opportunities as we head into 2020.

So in summary, another excellent quarter for Tools & Storage. This team continues to act with agility to react to the changes in the external environment while positioning the business for future growth and margin expansion.

Looking at the Industrials segment. The segment delivered 13% total revenue growth with the IES Attachments acquisition contributing 16 points, partially offset by a volume decline of 2% and a 1 point headwind from currency. Operating margin rate declined year-over-year to 15% as productivity gains and cost control were more than offset by the impact from lower Engineered Fastening volume and the externally driven cost inflation we experienced. Engineered Fastening organic revenues were down 4% as fastener share gains were offset by inventory reductions and lower production levels within the automotive and industrial customers. The market environment for this business remains challenged with underlying automotive production declining for the fifth consecutive quarter, and their industrial markets are showing signs of inventory reductions and slowing trends. Despite this, though, our auto fastener business showed positive organic growth in the quarter, demonstrating 300 basis points of content penetration gains relative to the underlying market.

The systems business within automotive, which is CapEx driven, as we know, showed low double-digit decline. And despite gaining share, the industrial fasteners business were down in the mid-single digits.

The Infrastructure business delivered 4% organic growth due to stronger onshore pipeline project and inspection activity in Oil & Gas. This was partially offset by lower Hydraulic Tools volume, which was impacted by a difficult scrap steel market.

And then finally, as Jim mentioned, the IES business and the related integration continues to hit all key expectations.

So as we turn to Security, this segment delivered organic growth of 1% in the third quarter. North America was up 3% organically driven by higher volumes within health care, automatic doors and electronic security. Europe was down 1% organically as strong growth in France was offset by continued adverse market conditions in the Nordics and the U.K.

In terms of profitability, the segment operating margin rate was 10.9%, down 20 basis points versus the prior year as organic growth and cost containment were offset by a 50 basis point impact from the Sargent & Greenleaf divestiture as well as investments to support the business transformation in commercial electronic security.

The modest growth achieved in the quarter was another encouraging step as the Security team begins delivering on the targeted investments we've made in digital, commercial talent and field technicians. These talent investments support the commercialization of new technology-enabled solutions focused on delivering customer insights through data analytics and an app-based solution for our small to medium enterprise customers. The forward-looking indicators remain positive as we continue to see mid-teens year-over-year improvements in orders and backlog. We're optimistic the team can continue to build upon their early wins to deliver consistent organic growth going forward.

So now let's turn to guidance. Looking at Page 7. We are revising our 2019 adjusted earnings per share guidance to \$8.35 up to \$8.45 from our previous range of \$8.50 to \$8.70. This new EPS guidance represents an increase of approximately 3% versus prior year at the midpoint while overcoming close to \$450 million in external headwinds from commodity inflation, currency and tariffs.

On a GAAP basis, we expect an earnings per share range of \$6.50 to \$6.60 compared to our prior range of \$7.50 to \$7.70.

In addition to the items impacting core guidance, the changes primarily attributed to additional -- an additional \$150 million of restructuring charges associated with the cost reduction program announced today.

Now let's dive into a little more detail in our 2019 adjusted EPS outlook. You can see on the left-hand side of the chart we estimate an incremental \$55 million in external headwinds related to tariffs and foreign exchange since providing guidance in late July. This additional impact is evenly split between currency and tariffs. The tariff-related headwind now includes the estimated impacts from List 4 China tariffs at 15%. Additionally, we are modestly reducing our expectation for organic growth, which reflects the slower growth environment we have been experiencing within our industrial channels and emerging markets. Our plan now calls for an above-market 3.5% to 4% organic growth as we continue to leverage our strong pipeline of organic growth catalysts in a choppy market growth environment. Partially offsetting these headwinds are incremental benefits from the margin resiliency initiative, incremental cost actions and a lower tax rate, which is now expected to approximate 16.5%.

Moving to free cash flow guidance. As we look in the third quarter, free cash flow was \$96 million, which brings our year-to-date performance to a use of cash of \$21 million, which is \$266 million better than the prior year. The year-to-date improvement versus 2018 is primarily related to higher net income, lower CapEx and reduced levels of working capital.

We remain confident that we will deliver strong cash flow generation for the year, utilizing our Core SFS processes and principles, combined with reducing working capital levels in line with normal seasonal activity. Therefore, we are reiterating our commitment to deliver a free cash flow conversion rate of approximately 85% to 90%.

So as we turn to the segment outlook on the right side of the page, we'll start with Tools & Storage, which assumptions call for mid-single-digit organic growth and a relatively flat to positive margin rate year-over-year. The team will continue to leverage price, cost actions, margin resiliency and, of course, volume to offset the external headwinds and deliver operating profit growth. We expect the fourth quarter to demonstrate margin rate expansion as we continue to take additional actions to offset the incremental impacts from currency and tariffs.

In the Industrial segment, we continue to expect a low single-digit organic decline, reflecting the slower market growth we've been experiencing across our general industrial and automotive end markets. Total growth is expected to be positive, including the contributions from our acquisitions. Operating margins are expected to be down year-over-year driven by lower volume and their share of the impact from these external headwinds.

And then finally, in our Security segment, we expect positive organic growth and operating margin rate and dollar expansion year-over-year as the team remains focused on realizing the benefits from our transformation strategy.

So as you start to think about the setup for 2020, I would like to provide you some insights.

As Jim indicated earlier, we are taking cost actions to help counteract the carryover effect of currency and likely tariff headwinds as well as softness in the industrial and emerging markets. The actions to adjust our cost base have commenced, and we are implementing a cost reduction program expected to deliver \$200 million in annual cost savings. The cost savings will come from headcount actions across the company as well as executing some footprint rationalization opportunities.

As we approach this cost reduction, we are focused on ensuring our commercial and innovation organizations have ample resources to continue growing above market and look toward areas where we can rationalize leadership structures or organizations to serve the

businesses more efficiently. In some cases, this meant accelerating existing organizational efficiency and plant footprint rationalization plans captured within the margin resiliency program. However, even with these cost actions announced today, we firmly believe we can achieve additional margin resiliency benefits in 2020 to ensure we are prepared for any potential new headwinds.

This \$200 million cost reduction program is a proactive response, which will allow our businesses to demonstrate a solid level of margin growth in 2020. So even with the likely carryover headwinds presumed -- previously mentioned and expected higher tax rate next year of approximately 3 points, we feel we have positioned the company for continued adjusted EPS and free cash flow growth next year.

So in summary for the whole company, we expect 3.5% to 4% organic growth for 2019, low single-digit EPS expansion, which is overcoming \$445 million of commodity-, currency- and tariff-related headwinds. These headwinds equate to almost \$2.50 of earnings per share impact.

The organization remains focused on executing our playbook to generate above-market growth, optimize our global supply chain, adjust our cost structure through the actions announced today and generate significant value with our margin resiliency program, which will ensure the business remains well positioned to deliver sustained above-market organic growth and earnings expansion in 2020 and beyond.

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

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

Well, thank you, Don.

Our Global Tools & Storage delivered strong performance in Q3 led by strength across North American retail and Europe. We've just completed the rollout of our impressive Craftsman range across hardware, wholesale, home center and e-commerce channels. The tremendous growth and share gain we are experiencing with Craftsman is accretive to our growth, which is accretive to the market.

The end user review and endorsement of our more than 2,500 Craftsman products is unprecedented. We have extraordinarily high confidence in our ability to deliver \$1 billion by 2021. We also see the opportunity to expand across industrial and automotive channels into the future.

Our DEWALT business continues to be robust, delivering double-digit growth led by strength across our FLEXVOLT franchise as we continue to advance across commercial applications as well as outdoor solutions. New product launches across DEWALT, Atomic and Xtreme ranges in 20-volt and 12-volt applications, respectively, offer the user best-in-world power-to-weight performance and has been immediately endorsed by users across the globe.

Finally, our expansion of Stanley and Stanley FatMax will exceed 100 products this year and continues to serve as a share gain enabler, consistent with our ambitious expectations.

In summary, tremendous new product development across Craftsman, DEWALT and Stanley has enabled growth and share gain throughout 2019, along with momentum carrying into 2020.

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

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

Thanks, Jeff, and great product story.

In summary, for the company, we delivered a solid 3Q with 4% organic growth, \$2.13 earnings per share, overcoming \$90 million in currency and tariff headwinds. This continues to require execution of price optimization, cost control and margin resiliency in response to the external cost pressures, which for 2019 are now \$125 million higher than our January guidance. Nonetheless, we will deliver in 2019 a respectable financial performance with 3.5% to 4% organic growth and year-over-year EPS expansion.

As we close out the year, we remain focused on day-to-day execution and operational excellence. This includes continuing to leverage our organic growth catalysts, realizing the initial benefits from our margin resiliency programs, successfully integrating our recent acquisitions and generating strong free cash flow. Our proactive \$200 million cost reduction program announced today will supplement these activities, providing us with the capability to perform in whatever environment we encounter in 2020.

Dennis, we are now ready for Q&A.

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Nigel Coe with Wolfe Research.

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

Great detail, as always. I just wanted to kind of dig into the \$200 million cost reduction program a bit deeper than we had maybe expected, and I know you've been sort of dancing around this preserving growth investments and making sure you don't harm growth potential but equally want to reduce costs as well. So I'm just wondering what this tells us about how you view the world in 2020, how you're preserving the growth investments and maybe addressing the -- any overlap between the margin resiliency program and what you're forecasting for 2020.

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

Okay. It's Jim. I'll tackle this one, Nigel, and then I'll have Don comment on the overlap as it relates to the numbers.

The -- first of all, the size of the program is a compromise between what -- the art of the possible and how much growth we want -- or how much cost we wanted to take out like any cost reduction program. And we were fortunate for a couple of reasons. Number one, we've had a few structural ideas percolating for a while here that have enabled us to combine a few organizations and drive more enterprise efficiencies. So in areas, for instance, like emerging markets and the Global Tools & Storage business where we segregated them about 6 years ago in order for us to focus more on the emerging markets to provide more of a focused effort on the emerging markets, especially in the growth area.

Now a couple of things have happened. First of all, the emerging markets have become more volatile and there's less growth in the near term there. And so we have also established an infrastructure in the emerging markets which is really solid now, and the focus has produced that, and so now we can combine that with the other assets of the Global Tools & Storage business, leveraging those assets across the entire globe. So I think that's a big one.

The other one is in the Industrial segment. We ran those 3 different enterprises separately, and now we're going to run them on a combined basis.

So those 2 structural changes have created a pretty significant opportunity for cost reduction.

And then there's just several functions that we are taking a more enterprise approach to. So for instance, I'll just pick one, communications and also marketing. Those 2 are now being done on much more of an enterprise basis, and that has resulted in pretty significant cost reductions. So those are a couple of the elements.

Another one is that for a long time, we haven't really looked at spans and layers across the organization, and we had been doing that in connection with the margin resiliency initiative. And as it turned out, there were a couple of pockets in the organization where we had grown more layers and the spans were lower than optimal. And so we've been able to take action in those areas. And I think that's a very

positive change because it creates agility -- even more agility for the organization.

So -- and with that, I'll turn it over to Don to talk about how much of the margin resiliency is overlap and how much of the \$300 million to \$500 million is consumed by the \$200 million.

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

Yes. So we expected that many of you folks will have this questions. And when you think about some of the things that Jim was describing, several of them are actually concepts that we had within the organizational efficiency pillar of margin resiliency.

So if you think about the \$200 million, I think probably the simplest way to think about it is probably about 1/3 of it, \$60 million to \$70 million, is really things that we pulled forward that we were contemplating as part of the margin resiliency. And then the remainder of it is really just looking across the entire enterprise for areas of efficiency, plant rationalization decisions, et cetera.

So the way I step back from it and look at this is the \$300 million to \$500 million that Jim reviewed earlier in the presentation, as we think about that going forward into 2020 and beyond, I still feel very confident that we can achieve the \$300 million to \$500 million above and beyond what we're talking about even with maybe \$60 million to \$70 million of that being consumed because I just think the opportunity is very significant. And we've dedicated a full-time team of people. We're putting one of our senior leaders in charge of it full time starting at the beginning of January, Steve Brodrick, who presented at the Investor Day on the topic. And so we are dedicating resources in the sense of people, resources in the sense of technology investments. And then we also brought in certain consulting resources on a minimal basis as well to ensure that we hit this objective over the next 3 to 4 years. But my confidence level actually goes up as each month goes by given the amount of effort and focus we have and the opportunity that we see.

Operator

Our next question comes from Tim Wojs of Baird.

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

I guess maybe just thinking about Craftsman. \$600 million kind of ending the year and a target for \$1 billion in 2021. I guess how should we think about the phasing of that incremental \$400 million over the next couple of years? And then is -- what's the opportunity for Craftsman beyond the \$1 billion as you look out even further beyond '21?

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

Yes. I'll take the question. It's planned at this point. So as Jim indicated, we've added \$500 million of organic growth since acquiring the Craftsman brand, putting us at about \$600 million this year. We have a high level of confidence that we can grow that to about \$800 million by the close of next year and to \$1 billion close of the following year to put us very much on track to the \$1 billion objective we set. And we still have opportunity beyond that from new product development and category expansion within the existing base but then also, as I intimated earlier, opportunities for that Craftsman brand in the Industrial and automotive space, which is a place that it had kind of builder's reputation over the last 90 years. So we have very high confidence on that attainment plan of \$200 million over a year for the next 2 years to reach \$1 billion and growth beyond that clearly. So high level of confidence and endorsement of the Craftsman growth plan.

Operator

Our next question comes from Deepa Raghavan with Wells Fargo Securities.

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

I have a margin question. Apologize, it has couple of parts to it, but I guess I could use some clarity. First off, how is the 2/3 of the \$200 million in new cost actions different from the margin resiliency measures? I.e., do those costs come back once the environment improves? That's one part of it.

The second part is can you talk about your updated thoughts on the \$300 million to \$500 million in cost actions? Is that range still sufficient given weakening backdrop? Or can a majority of those cost actions or saves be pulled forward well before 2022 if macros



weaken further here? Or should we think about that as there's a gestation period or a staggering period to these cost actions and they just cannot be pulled forward before 2022?

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

Yes. I will -- as I mentioned in response to Nigel's question, of the \$200 million, yes, about 1/3 of it, we -- and basically, what we've done is we've accelerated some margin resiliency initiatives, and Jim gave some good examples of what those were when he responded to a portion of that question such as emerging markets and core tools coming back together, combining our 3 Industrial businesses and running them at one platform, et cetera. So those were pulled forward as an acceleration. But what I also said was that I felt confident even with that pull-forward that we still can achieve \$300 million to \$500 million of margin resiliency starting next year and beyond in addition to that. And so -- and we don't feel like we've done anything here that significantly changes our view on that \$300 million to \$500 million. And that will commence in a significant way starting next year as a way for us to build contingency against new potential headwinds, and I've said publicly before that we think that's about \$100 million to \$150 million per year starting next year, and then we'll have a subsequent few years after that to achieve the number that I just -- or the range that I just described. I think that's the best way to think about it.

We have not done anything to minimize the potential impact of that \$300 million to \$500 million, which means if you're -- if you add those 2 things together, we think the opportunity is a little bit bigger now.

Operator

Our next question comes from Julian Mitchell with Barclays.

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

Maybe just a clarification around if we think about the overall external headwinds into next year, was that the \$100 million or -- and \$150 million? Or is that at a slightly different number as you see it today versus the \$445 million this year? And when we're thinking about the total scale of the cost reduction plans, the stuff in May and what you've announced today, are those scaled with a view to still being able to hit maybe the low end of the medium-term EPS growth guide that you had laid out back in May? Or is that very much still a question and we'll revisit it when you guide formally for next year?

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

Yes. So as it relates to the headwinds as we go into next year, if you just look at what the headwinds that are in place today, which would be with lists 1, 2, 3 and then List 4A, the carryover effect of that is about \$100 million. And then if the second List 4 happens in December, which is List 4B, which will be the remainder of items that come from China that have not -- do not have a tariff on it today, that would be another 125 -- another \$25 million of carryover impacts. So the total of those 2 would be \$125 million assuming that second List 4 happens.

FX carryover right now looks to be about \$30 million to \$40 million of an impact next year. So in total, we're somewhere in the \$155 million to \$165 million carryover impacts of all those items. It does not -- that does not encompass if there is an increase to any of the tariffs going -- like there were things being discussed of going from 25% to 30%. If that occurred on lists 1, 2, 3, that would be another \$55 million. So you're getting to a number of around \$210 million to \$215 million, roughly, at that point in time. And so think we think we've taken enough actions at this stage related to the \$200 million to offset what is known, but we've also put a little bit of cushion in there for the likely or possible increase in some of these tariffs as we think about that going into 2020.

On the second part of the question, I think at this stage we feel like we've positioned ourselves to grow our EPS. And as we close out the fourth quarter and we give guidance in January, we'll give more specifics and details. But with these headwinds I just described and the tax headwind year-over-year, as I mentioned in the presentation, we still see a path to demonstrate, as Jim said, solid EPS growth.

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

And I would also note that this is a little bit different than in the past because in the past, we've -- historically, in last couple of years anyway, we've averaged about 40% price recovery on these tariffs. What we've done here is recovered the entirety of the tariffs with cost actions. And the question would be what's the market outlook next year. Is it going to trend negatively or is it not? So what we're really

trying to do with margin resiliency plus also covering 100% of the tariff exposure with cost actions is to make sure that we have a very significant cushion in this -- in the event that the economy takes a turn for the worse. We're not predicting that. We don't see it. We see it in Industrial and we see it in some of the emerging markets and so on, but we don't see it in the core of our business, which is the North American retail. And in Europe, we see a little slower but still not terribly negative on the construction and DIY side. So I think it's a very prudent way to go into the year. I think we're set up really nicely, and we'll see where we go from here.

Operator

Our next question comes from Michael Rehaut with JPMorgan.

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

First question, I just wanted to get -- appreciate all the detail, and I guess just a couple of the remaining pieces of the puzzle at least as people are trying to do some of the math around 2020.

You've hit on the carryover from tariffs in different scenarios and FX. I was just curious at this point in time if you had a sense about raw materials, and if -- we've had other companies start to talk about it being a slight tailwind next year, how 2019 is shaping up from a raw material standpoint and, if we just froze today in time, how that might flow into 2020.

And also, on the margin -- I'm sorry, on the cost cutting initiatives, the cost reduction initiatives, the \$200 million, should we be expecting that to fully be realized in 2020 or maybe even partially be realized in the fourth quarter and the bulk remaining in 2020? Just a sense of timing on that.

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

Yes. Sure. So as it relates to commodity inflation, as we said back in the July earnings call, we expected a little bit of moderation of that in the fourth quarter this year. We're still expecting that is still baked into our guidance assumption as it was in July. Not a significant number, but we are seeing a little bit of positive trend there.

We're still trying to finalize expectations for next year related to commodity inflation. But at this stage, trends are good in certain areas. Other areas, they're not as positive. But overall, we think we still will see some level of deflation. Probably not of deflation at this stage, but we still have a lot of work to do over the next 2 to 3 months to really nail that down because we also do see that as an opportunity as we go into 2020 to see if we can achieve some deflation in that particular area, which is just another area that allows us to build contingency as we think about some of the -- any new headwinds or, as Jim mentioned, the more difficult markets that might evolve.

On the second part of the question, which was related to what -- Dennis, what was the second part?

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

How much cost saving heading into next year.

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

Oh, cost savings. The vast majority of the \$200 million is next year. It's a very small impact here in the fourth quarter. And so I was factoring the \$200 million hitting in 2020.

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*

Can I just get a clarification on the tariffs? So the impact to this year, it doesn't seem like it's really changed much from what you guys said intra-quarter. But then if I looked at the lists 1, 2, 3 tariffs that were supposed to increase in October 15, that seemed to have gotten delayed. And so is that -- is the increase embedded in your 4Q guide? Or is the delay embedded in your 4Q guide? Just some clarification around that would be helpful.

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

Well, the increase that happened in the third quarter is embedded in our guide related to List 4A. The change from not going to 30%, which was what was kind of the relief that was given a few weeks ago where lists 1, 2, 3 was going to go from 25% to 30%, that is not factored into our guidance.

Operator

Our next question comes from Josh Pokrzywinski with Morgan Stanley.

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

Just on the cost savings side, Don, is there anything else besides the initiatives you guys have announced today that blends into next year? Obviously, there's a lot going on in 2019 that you've been working on all year. But any carryover from that?

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

From the cost actions specifically? No. I guess you're referring to other cost actions we've done, Josh?

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

He's probably off the line. So I assume that's what you're talking about, other cost actions that we've taken throughout the year. Yes, there's a little bit of carryover effect related to some of the margin resiliency initiatives we've done. But I wouldn't say there's anything significant. It's probably in the \$10 million to \$15 million range. It's not something very significant.

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 maybe just one clarification on restructuring for the \$200 million savings. Just thinking about how the cadence spreads over 2020 since some of this is like plant rationalization, which to me seems to take a little bit longer than the more basic kind of tariff reduction stuff.

And then one question that isn't around tariffs or restructuring. You guys still have conviction in Tools & Storage margins returning to positive territory in 4Q. If you could talk about like the drivers of that conviction since we just haven't seen that play out so far year-to-date.

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

Yes. So if you -- to start with your first question, I would say that the cadence by quarter next year for the \$200 million benefits will be pretty even, about \$50 million per quarter because of the vast majority -- a large part of that will be completed by the end of -- or going -- the beginning of the first quarter. There will be some planned things that are a little bit delayed. But frankly, the magnitude of that is not going to change that cadence dramatically.

The -- as far as the tools' margin rates, I mean, actually, we had a great second quarter where our margin rate was up 80 basis points versus the prior year. The third quarter was flat versus the prior year, and now we expect the fourth quarter to be up, as I mentioned. And so actually, we did turn the corner on that in the second quarter. The first quarter was down significantly because that was really the biggest quarter of headwinds just looking at an individual quarter for this year. But that trend has changed in the second quarter in a big way. We saw some new headwinds emerge in the third quarter that didn't allow us to grow the rate, but it was flat year-over-year. And in the fourth quarter, we'll be able to grow as -- because now we're able to take some actions in response to those new headwinds that allow us to do that. And then you combine it with the fact that the rate was pretty low last year given the fourth quarter was hit with some pretty significant headwinds as they started in the third, fourth quarter of last year, as they went into the first quarter.

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

In my remarks, I mentioned that from our January guidance through present, we've had \$125 million of evolving, growing headwinds during the year. I think for us to drive that margin story -- and most of those were in tools. So for us to be able to perform at that margin rates that we have under the circumstances, I think it's been a fairly impressive story in the face of some pretty significant adversity.

Operator

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

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

Just a couple of questions rolled up in one is just where in the P&L will these initiatives, the \$200 million initiatives, show up both on a consolidated basis but also the segment basis? And you had, I think, \$250 million of cost cuts last year, another \$200 million that rolled into this year and another \$200 million next year. And then you also talk about the \$300 million to \$500 million. I'd like to kind of maybe parse out where that falls, where you think that's going to shine in the margin structure. And then lastly, if tariffs are removed, how do you think your margins respond in that scenario, in a good case scenario that we find resolution?

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

Yes. I would say that the cost actions are across the entire company. So every business that participated, the corporate functions that participated. So the impact to them will be spread across all those different categories based on the magnitude of spend. So you can probably easily do the math. It's on the level of SG&A that we have in each business and at corporate and just kind of apply that percentage against the total SG&A for the company, and that's pretty much what it's going to do for next year.

As we think about the \$300 million to \$500 million going forward, that, again, will benefit every business. I mean I think the magnitude will -- from a dollar perspective will be larger in Tools & Storage just because it's a much bigger business. And the opportunities are on next-gen procurement, Industry 4.0 and those types of things will definitely hit that business in a bigger way. And so at the end of the day, there could be a little bit more heavy weighting to tools given that some of those things are really more specific to our tools business and the manufacturing footprint that they have or the procurement processes and the organization they have. But I don't think it's a dramatic shift. I think you can look at that and probably recognize that every piece of the company is going to feel the benefits of that over the next 3 to 4 years.

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

And I want to answer the best part of your question, which is what if they go away. Well, the reality is we don't expect them to go away, and that's...

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

You love to talk about it.

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

I don't often get an opportunity to discuss it, so I'm going to enjoy it. But the total tariff impact, I think, built in at this point is \$425 million annualized. And as I mentioned earlier, the -- we've been recovering through price about 40% of -- historically anyway of the tariff impact. So I think the really good news is if the tariffs are removed, yes, the customers are going to want some money back, and we'll probably want to give back at least some of it because -- for the price elasticity of the end products -- end markets. But in reality, there's a pretty significant chunk of tariff impact headwind that would not be given back or at least we'd have the flexibility to do what we want with it. And frankly, it'd be nice to see that drop through to the margin line. So yes, thank you for that question.

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

And the 4 -- just to clarify, the \$425 million would assume all of List 4 happens and lists 1, 2, 3 gets another 5% on it. So that would kind of be the scenario that I laid out where if all these things went in a negative way, it would be \$425 million on an annualized basis. Based on what we know today, the number would be \$345 million.

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

Still very big.

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

Yes.

Operator

Our next question comes from Ken Zener with KeyBanc.

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

I understand your actions are attempting to address all the inflation through your own actions, not through the market pricing. I'm wondering, could you -- obviously, it's a more conservative approach, but what does it tell us perhaps about consumer elasticity or the retailers' willingness so far to accept more price increases and/or how your competitors are getting impacted as these tariffs impact product that's fully assembled?

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

I mean obviously, we can't get into a detailed discussion of competitive dynamics. We have our General Counsel sitting at the end of the table here looking at us, but we'd never do that. However, I will say that, that 40% that we've recovered, we were unfairly, in my opinion, hit with tariffs on componentry for products that we made in the United States, which is pretty significant for us relative to competition. And up until List 4, our competitors were not feeling that same impact. So we were in a position for a while, until List 4 came about, that we were competitively disadvantaged. Now with List 4, it changes the playing field. And at these levels, you could even argue it's somewhat in our favor now.

So I think what happened over time was that the competitors did some pricing actions, probably not to the extent that we did. And so it's interesting, when you look at the volume performance of Stanley Black & Decker vis-à-vis the competitors, we're doing pretty well. So I don't -- I haven't studied economics since college, but I would say that we have -- I think through our value propositions in some of the products that Jeff Ansell talked about, whether it's Craftsman, whether it's Xtreme, FLEXVOLT, Atomic or Stanley, Stanley FatMax, I mean, I think all of these product actions, in addition to a lot of our commercial excellence activities and our scale and our global reach, et cetera, have enabled us to gain share and to avoid the elasticity trap of some -- of what we otherwise would have experienced. So it's a real testament to the strength of our value proposition and our commercial execution that we've been able to put numbers on the board in organic growth at the level we have been.

Operator

Our last question comes from Rob Wertheimer with Melius.

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

It's a minor question. Just on the fastener side, obviously the entire Industrial colony has a little bit of excess inventory probably trade war related. Is that sort of excess inventory correction done and next year you get a chance to ride up and down with the markets? Or is there a little bit more? And then relatedly, I don't suppose there's excess inventory in the big-box channel, but just to sort of check in on that question if that's any kind of a risk.

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

Let me take industrial piece and then I'll -- then we'll hand it over to Jeff on the big-box side. So on the Industrial side, I wouldn't call it excess inventory. I would call it a combination of the manufacturing markets are slowing, and so you're seeing a little bit of an impact of that. And then you're just seeing what I would call more normal inventory corrections that occur at this stage of a slowdown. And so we've seen a slowdown start in the second quarter and continue to the third quarter, likely will continue for at least a portion of the fourth quarter. And so what we're just seeing is our customers really just focused on tightening their inventory levels. But I wouldn't have described it as excess inventory before. Jeff?

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

Regarding the second part of the question, the POS that Jim and Don have referenced has been incredibly positive all year and accelerated over the last 22 weeks. But it's the POS -- the double-digit POS that we have achieved year-to-date and continues as we speak has been in balance with inventory. So we don't see any excess inventory in aggregate across the home center channel, and POS continues to be a really robust story for us across all the brands we've referenced. So all in all, things are holding together really well and share gain continues to be in our favor.

Operator

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

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

Shannon, thanks.

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

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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