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SWK - Q1 2015 Stanley Black & Decker Inc Earnings Call

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OVERVIEW:

Co. reported 1Q15 YoverY organic revenue growth of 8% and EPS of \$1.07. Expects full-year 2015 GAAP EPS to be \$5.65-5.85.



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PRESENTATION

Operator

Welcome to the Q1 2015 Stanley Black & Decker, Incorporated, earnings conference call. My name is John, and I will be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded.

And 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 & Government Relations*

Thank you, John. Good morning, everyone, and thank you for joining us for Stanley Black & Decker's first-quarter 2015 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 section 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 PM today. The replay number and the access code are in our press release.

This morning, John, Jim and Don will review our first-quarter 2015 results and various other matters, followed by a Q and A session. Consistent with prior calls, we are going to be sticking with just one question per caller.



And as we normally do, we will be making some forward-looking statements during the call. Such statements are based on assumptions of future events that may not prove to be accurate, and as such, they involve risk and uncertainty. It is, 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 1934 Act filing.

I will now turn the call over to our Chairman and CEO, John Lundgren.

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

Thanks, Greg. And thanks, everybody, for joining us this morning. We've got a strong quarter, and I think a lot of encouraging news, that we're very much looking forward to sharing with you, and then taking your questions.

During the quarter, revenue expanded 8% organically. Total growth was 1%, but the top-line impact of foreign currency was negative 7% in the quarter.

Our Tools& Storage and Engineered Fastening businesses all continued strong momentum. They both grew in the double digits organically. And Security built off the momentum from the fourth quarter, and posted 2% organic growth, as North America and emerging markets, as well as Europe, grew organically within the quarter. I won't dwell on those numbers because Jim is going to dive into much more detail on the segments in just a minute.

Both gross and operating margin rates expanded in the first quarter: 50 basis points in gross margin and 120 basis points in operating margins. The increase is due to higher volume, along with a sharp cost focus and price realization delivering operating leverage, despite \$50 million of foreign currency pressure, just within the quarter. Earnings per share were \$1.07, flat versus the first quarter of 2014, as the strong business performance, most notably in Tools and Storage, offset higher planned restructuring and tax rate.

Due, in part, to our strong fourth-quarter cash flow, in conjunction with our previously communicated equity derivatives, we executed repurchase actions that reduced the share count by approximately 8 million shares in the first quarter. This was a meaningful acceleration versus our prior plan.

We're also reiterating full-year 2015 guidance for earnings in the range of \$5.65 to \$5.85 on a GAAP basis. That's inclusive of \$0.25 a share in restructuring charges. So, it represents a 5% to 9% year-over-year EPS growth, despite \$60 million to \$70 million of incremental foreign exchange pressure since our last report, and it's now expected to total between \$200 million and \$220 million in 2015.

We're also reiterating our free cash flow outlook of at least \$1 billion. Don is going to walk you through the moving pieces and our assumptions around them with respect to the share repurchase, currency impact, and cash flow in just a few minutes.

Moving to the next slide, and looking where the growth came from, the momentum continues in the developed markets, and that's been led by the US. As I said, another solid quarter of organic growth, but with currency headwinds almost 2 times what we experienced during the fourth quarter of 2014. The organic growth of 8% came on the heels of 7% organic growth in the fourth quarter; so, over the last eight quarters, our organic growth has averaged 5%, right in the mid-point of our targeted 4% to 6% range.

Strong volume growth, particularly in the US; but we also had solid growth in every other region of the world, as you can see in the box on the right. Pricing was again positive in the quarter, as actions to combat currency, primarily in the emerging markets, but also surgical pricing actions at the remainder of our businesses are contributing to the organic growth.

Currency headwinds did intensify as we moved through the quarter. They ramped up toward the end of the quarter. And they did dampen the organic performance by 7%, as I previously said, as the dollar strengthened against almost every currency in countries where we do business. And Don is going to give you a very granular look at that, in his portion of the presentation.

Just quickly, on a regional basis, demand in the US remains very healthy, particularly in retail, both strong sell-in and flow-through, in the Industrial channel, as well as within our Security business. Europe's been a very pleasant surprise, as we continue to show strong share gains, most notably in Tools and Storage, as well as our Industrial business. As you can see, total organic growth is 6%, with these markets tracking flat to slightly up, maybe in low-single digits. And finally, the emerging markets were aided by strong shipments in our Engineered Fastening, Automotive and Electronics businesses, while certain markets, most notably Russia, remained under a lot of pressure.

Let's move it over to Jim, and he can give you a lot of detail on the segments.

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

Thank you, John. I think this first-quarter performance, on the heels of a very strong showing in 2014, is indicative not only of how far we have come in pursuit of exceptional value creation, but also how much potential there is ahead of us. The title of our opening slide this morning is: accelerating organic growth and margin expansion. That is a topic we are very excited about here at the Company.

The record 8% organic growth is notable, considering that the US is one of the only major world economies with legs. European economic growth is still spotty, at best, and emerging markets in the aggregate are weak, and getting slightly weaker. The 120-basis-point operating margin expansion speaks clearly to the underlying operational strength and volume leverage potential of the Company, especially when viewed in the context of overcoming well over 100 basis points of year-over-year currency headwinds.

Our ability to upgrade total-year organic growth guidance to 5%, and hold EPS guidance in the 5% to 9% growth range, despite total FX headwinds of between \$1.00 to \$1.10 a share, means that the underlying organic EPS growth of the Company for 2015 is expected to be somewhere between 25% and 30%. Our Global Tools franchise is on a tear, gaining share, and hitting on virtually all cylinders. Our large, highly profitable Engineered Fastening business has fully digested the successful Infastech acquisition, and is growing at rates well above market. Security is now generating positive, albeit modest, organic growth, and is tracking to previously communicated improvement benchmarks; and thus, offers more in the way of future value-creation upside than downside.

So, overall, we emerged from Q1 2015 with strong operating momentum, and conviction that despite one of the tougher operating environments in recollection, we can continue to perform well. In a few minutes, I will conclude my section with some commentary on how we plan to keep the growth and operating margin expansion momentum going. But first, I will provide some color on segment-level performance, starting with Tools and Storage, which offered up another outstanding quarter.

Total Tools and Storage revenue was up 3%, and operating margin grew 21% to 15.7%, demonstrating impressive operating leverage. Gains resulted from volume leverage, modestly positive price, operations productivity, and tight SG&A cost management, which more than offset the severe currency headwinds.

Organic growth was again in double-digit territory; this time 10%. North America was up 15%. Europe once again delivered outsized growth; in this case up 9% organically. Emerging markets were flat, as 9% growth in Latin America was wiped out by a steep, greater than 50% decline in Russia, and minus 8% growth in Asia, as softness in China prevailed.

The mid-price-point product rollout continues to proceed well, and this important initiative provided support for the emerging market organic revenues, and prevented them from contraction in the quarter. Across Global Tools and Storage, organic strength was broad based once again, with professional power tools up 13%; consumer power tools up 10%; accessories up 13%; and Hand Tools and Storage up 7%. All categories benefited from strong new-product introduction momentum and customer-level execution.

POS and major box customers in the US was robust, despite less-than-ideal weather conditions, and aggregate weeks at hand decreased during the quarter. We believe sell-through in the hardware, lumber store and STAFDA channels was also very strong, as both resi and non-resi construction markets benefited from good growth and end-user demand.



Industrial markets in the US were somewhat weaker than we saw in 2014, but still positive. Our best guess is that the total US tool market was up about 5%, including power tools, which we believe was up a slightly higher rate, maybe 7%. The European market, as measured in local currency, continued to be soft, perhaps up 1 point or 2. So, in the developed markets, we believe we continued our share-gain momentum during the quarter.

As Tools and Storage, which was previously known as CDIY and IAR recently combined, continues to rack up gains, now in its combined form, the question we often get is: What exactly is management doing to drive the performance? The simple answer is we are taking a great asset, feeding the new product innovation machine, and coupling it with outstanding commercial and supply chain execution.

By combining Stanley and Black & Decker five years ago, we created the world's leading tool company, with power tools, hand tools, storage and accessories, as well as a broad array of leading brands, global scale, and the only tool company in the world with meaningful presence across all four major channels: construction, DIY, Industrial, and automotive repair.

We executed the integration well, extracting over \$500 million of cost synergies, and greatly exceeded our original targets for both cost and revenue synergies. Most importantly, we fused these Companies together by creating a winning culture with both an innovation growth orientation and operational discipline, enabled by the Stanley Fulfillment System.

What we are experiencing today in terms of performance is the manifestation of all of the above. It was a great idea on paper; in practice, it is exceeding our expectations. We look forward to delving more deeply into this story, as well as offering insight into how we plan to keep the growth going, with those of you who are interested, at our upcoming Analyst Day on May 15.

Now moving to Security: It was a modestly successful, in-line quarter for Security, which registered 2% organic growth and 110 basis points of operating margin rate accretion, while facing an overall 6% revenue decline as FX took its toll. Nonetheless, operating margin was up 4%. North America and emerging markets revenue was up 2% organically, and Europe was up 1% on the same basis.

Notably, the European team delivered the first organic growth quarter for this unit since Niscayah was acquired in 2011. This came on the heels of a flat organic growth performance in 4Q 2014.

During several 2014 investor conference calls, we foreshadowed that the next marker in the European turnaround would be shifting from negative organic growth to modestly positive growth, something we expected to occur sometime in 2015. Having first wrestled European attrition to rates within our target range of 10% to 12% during the first half of 2014, as of 1Q 2015, we have stabilized the value of our recurring revenue portfolio, and are now in a position to achieve positive overall Security -- European Security -- organic growth on a prospective basis.

The benefit of revenue stabilization was clear in the quarter, as the team delivered its internal operating margin commitment, a \$4-million increase over prior year. Late last week I visited with them in London, and can say that they are fully grounded in what they have to do to continue the positive trend, and they have both the substance and the strength of conviction to back it up. So, I would look for continued progress on that front.

The other really positive turn-around news in Security was the commercial lock business in North America, which delivered 4% organic growth; their first positive growth quarter since fully converting to the independent distribution model in early 2013. Also on a positive note, automatic doors continued along its strong growth trajectory.

In summary now, two full quarters into the leadership adjustments in both Europe and North America, the early returns are promising. Both units are poised to deliver improving organic revenue and operating margin results, while continuing their recent track record of predictability. And as I mentioned last quarter, we expect the overall Security recovery to be slow and steady during the next several quarters, but we do expect it to continue to gain momentum as 2015 progresses.

Now turning to Industrial: Industrial had a mixed quarter, with an outstanding performance from Engineered Fastening, the largest part of it, offset by market-related issues in oil and gas. The net result was a 2% decrease in revenue, with 6% organic growth, but oil and gas deleveraging, and FX pressures decreased operating margin by \$12 million or 14%, bringing the rate down 210 basis points to a still-respectable 15.3%.



Engineered Fastening achieved a very strong 12% organic growth, including a plus-20% performance in the automotive sector, aided by strong equipment and fastener growth. This was in contrast to global light-vehicle production, which was up 1%. With about two-thirds of their business overseas, FX wiped out 10 points of Engineered Fastening revenue growth, so their total revenue was up only 2%. Nonetheless, they achieved both absolute margin growth and rate accretion.

Infrastructure, which includes oil and gas, and hydraulics, was down 15%. Oil and gas, approximately 2% of total Company revenues, was down 23% organically, as the market-related contraction in pipeline activity depressed the top line. All in all, a solid operational performance by the Engineered Fastening team, mitigated but could not completely offset the OM pressure from both the market-related issues in oil and gas, and currency.

So, there were a lot of moving parts to our total Company first-quarter story, but the punch-line is 8% organic growth with 120 basis points of OM expansion, while overcoming well over 100 basis points of year-over-year currency headwinds. Clearly, this management team is executing at a high level, despite numerous external obstacles, with the biggest being the strong dollar. We have confidence in our total-year outlook that we will continue to overcome these obstacles and deliver.

However, a natural question from the investment community is "what's next"? We plan to answer that question for both the total Company and for its individual parts on May 15 during our Investor Day at our Tools and Storage headquarters in Towson, Maryland.

An important part of the story will be a deep dive into the Stanley Fulfillment System 2.0, otherwise known as SFS 2.0. This is an initiative which we have been quietly working on for over a year. It is the next chapter in the evolution of SFS, which many of you know is a key element of our culture, and has been for over eight years.

SFS has enabled us to achieve a high level of customer-facing supply-chain execution and working-capital efficiency, as well as generating well over \$1 billion of free cash flow since its inception. SFS 2.0 is the next iteration of that business system, which focuses on fueling additional organic growth and margin expansion in the coming years. It is an exciting set of initiatives, which provides us with a clear path to differentiated outperformance, leveraging off the base that we have already created.

The initiatives are listed on this slide. It starts with core SFS, which is simply a continuation of what we had been doing for years, supplemented by four new elements: digital excellence, breakthrough innovation, commercial excellence, and functional transformation. We will provide greater insight into these elements, as well as business strategies, portfolio strategy, and acquisition criteria, as well as capital allocation and financial objectives, at the upcoming May Investor Day.

With that, I'll turn it over to Don Allan, our CFO, for his comments.

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

Thank you, Jim.

I'm going to start by spending a little time on our first-quarter free cash flow performance, which was an outflow of \$243 million. This is relatively consistent with prior year, and typical of normal seasonality that we see in our Company, where our inventory levels rise, especially in the Tools and Storage business, to ensure we are adequately prepared for Q2 and Q3 demands of key customers, in particular in our mature or developed markets. However, the incremental investment we made in Tools and Storage inventory during the first quarter of this year was modestly higher than normal, as we managed through the West Coast port strike, and we prepared for strong organic growth to reoccur in the second quarter of this year.

The core SFS principals, as Jim just mentioned, require agility to respond when business conditions change, such as strong organic growth, such as we have experienced over the last three quarters. SFS has enabled us to reach working-capital and asset-efficiency levels that are considered world class compared to other Industrial and Security peers. And SFS continues to assist us on our journey to 10 times working-capitalturns. Plus, we want to ensure we are agile in changing market conditions, just like we saw over the last few quarters.



Due to our confidence in our ability to generate at least \$1 billion of free cash flow during 2015, as John mentioned, we were able to accelerate our share repurchase activity relating to our repurchase program that we announced at the end of 2013. By using a mixture of cash repurchases and equity derivatives, we took actions to lower the share count by roughly 8 million shares within the first quarter, and 9.6 million shares since the beginning of the fourth quarter of 2014. This brings our cumulative total share actions to the equivalent of approximately \$900 million for the program that we announced in the fourth quarter of 2014.

Moving to page 11: As John touched on, and as all of us are well aware, another significant weakening of currencies versus the US dollar occurred during February and March of this year. Given this shift, I would like to spend a few minutes updating you on our 2015 foreign currency impacts. For us, it resulted in significant incremental currency pressure, most notably from movements in the Brazilian real, many other Latin American currencies, and several other currencies that moved in concert with the euro.

The results of these fluctuations has created a total negative annual impact of \$200 million to \$220 million versus 2014, which is an incremental headwind of \$60 million to \$70 million versus what we communicated during our earnings call in January. As a reminder, these amounts are net of our derivative hedging activities.

The incremental currency headwinds of \$60 million to \$70 million have been broad based. And in fact, our top exposures of the Brazilian real, the euro, the Canadian dollar, and the Argentinean peso represent only approximately \$30 million of this incremental impact, with two-thirds of that \$30-million impact due specifically to the Brazilian real. This demonstrates the positive impact of our euro and Canadian dollar hedging program in 2015.

As you may recall, I spoke of increased hedges on the euro and Canadian dollar in January; and while those currencies moved negatively during the first quarter, much of that impact was mitigated by these hedges. The remaining portion of the \$60 million to \$70 million incremental headwind from currency is caused by exposures in approximately 20 countries around the world, which clearly demonstrates the broad-based nature of this currency movement.

As we have reviewed during past calls, we attempt to mitigate these currency impacts in our P&L, beyond what we do in hedging activities, through a multi-stepped approach. The first is pursuing customer price increases where large transactional FX headwinds emerge, due to importing of US-dollar-based products or components, specifically in the countries such as Canada, Brazil, and even parts of Europe.

The second area of focus is we focus on improving our cost base through the pursuit of likely commodity deflation in this environment, which we have been seeing in the last three to six months, as well as we evaluate pulling forward certain specific cost rationalization projects for selected businesses and functions to ensure that we try to offset this impact.

And then the last area, which we can never lose sight of, is the long-term pursuit of increasing our localized production and component supply in certain key emerging markets around the world to minimize this impact. So, in summary on this page, we continue to actively manage a difficult currency environment, with a proactive approach that has enabled us to manage near-term volatility, but at the same time balancing the requirement of continuing to invest for future growth.

So, let's move to page 12, and talk about the 2015 EPS outlook. As indicated by John and Jim's comments earlier, we are reiterating 2015 guidance at \$5.65 to \$5.85 EPS, and free cash flow of at least \$1 billion, as the strong organic growth performance in Tools and Storage, combined with an acceleration of our share repurchase actions, has allowed us to offset the incremental currency headwinds that I just described.

Let's walk through these assumptions, which net to a neutral impact on our guidance, in a little more detail. First, we expect organic growth to be approximately 5% versus our prior expectation of 3% to 4%. This change recognizes the strong organic growth momentum that emerged in the second half of 2014 with our Tools and Storage business, which we expect to continue for the coming months.

Additionally, as we saw in the first quarter, our two other segments are generally on track to their planned organic growth rates, and we expect this trend to continue for the remainder of the year. This overall improved organic growth performance contributes an incremental \$0.25 of EPS impact for the full year of 2015, which is over and above the \$0.45 to \$0.55 EPS benefit we described in our initial guidance back in January.



The second item is our ability to accelerate our share count actions into the first quarter of 2015, given our confidence in cash flow outlook that I described earlier. Specifically, we executed cash repurchases and equity derivatives that reduced our share count by approximately 8 million shares. Our prior assumption was that much of these actions were to occur during the second half of 2015. We did increase our debt levels modestly to execute this plan, and combined with normal first-quarter seasonality of cash outflow, this increase in debt will be a temporary phenomenon. The results of these share count actions are a benefit of approximately \$0.10 of EPS, over and above the initial range we provided in January of \$0.09 to \$0.12 of EPS.

And then finally, as I just covered in a fair amount of detail, we expect \$200 million to \$220 million of currency pressure, given the strengthening of the US dollar over the past 90 days, versus our prior expectation of \$140 million to \$150 million. This will generate an incremental \$0.30 to \$0.35 of EPS headwind for 2015. Also keep in mind that our other planning assumptions, including tax rate and restructuring costs, remain the same for the full year.

There's three other items that are important to take note of, related to guidance, as you start to think about the different quarters and how they stage for the full year. The first item though is related to revenue, and the adverse currency impact is now expected to be approximately 7% versus our prior assumption of approximately 4% to 5% for the full year. This will result in total revenues being down approximately 2% on the full year. Second item is restructuring charges in the first half of 2015 will approximate 80% of our full-year expected restructuring charges of \$50 million. And then finally, I'll remind everyone to recognize the seasonality of revenues and profitability that happens in our Company every year in the first half.

We expect that our operating margin as a percentage of the full year to be relatively consistent with 2014 when you evaluate first half versus second half. However, higher planned restructuring charges and a higher tax rate in the first half of 2015 will result in first-half EPS approximating 43% of the full-year EPS, which is modestly lower than the 2014 first half as a percentage of the full year, and clearly due to the dynamics of restructuring and tax.

Now let's turn to segments, which are represented on the right side of the page and in our new reporting structure. We expect mid- to single-high-digit organic growth in the Tools and Storage business, as well as solid operating margin rate expansion year over year. The operating margin expansion is expected to be due to volume leverage, cost actions, and price, which more than offsets the negative currency impact. Organic growth within this segment is expected to remain strong in the first half, and show lower levels of growth in the back half, as we begin to experience more difficult comparables.

Our Security segment will have a modest organic revenue growth for the full year, with the margin rate increasing versus the prior year. The organic growth in Security North America and emerging markets will complement an improving performance in Security Europe, which started the year with good momentum, as you heard from Jim earlier. Profitability in Security will continue to improve versus prior year, from volume leverage and cost actions, which, again, will allow us to more than offset the foreign currency impact. We expect solid year-over-year profit improvement, as we continue progressing forward with our Security Europe multi-year recovery plan.

And then finally, for Industrial, we expect solid mid-single-digit organic growth, as Engineered Fastening strength will be able to offset the expected declines in our oil and gas business. However, due to the now increased importance of oil and gas as a percentage of this particular segment, we do expect margins to be relatively flat versus the prior year. The volume leverage generated by Engineered Fastening will be offset by the deleveraging impact of oil and gas, due to the sluggish market conditions in that particular business. This assumption change is more about the impact of recasting our reporting segments than it is a change in business assumptions since January.

So, in summary, the strength of our Tools and Storage organic growth, combined with accelerated share count action, offsets the higher foreign currency impacts I just described. Therefore, we still expect to achieve solid operating leverage on healthy organic growth, even with the incremental currency headwinds, which means we expect earnings will expand 5% to 9% on an overall revenue decline of 2% in 2015. Additionally, we believe we will continue to demonstrate strong free cash flow, as it will be at least \$1 billion.



So, to summarize the presentation portion of our call today, we believe we delivered a very strong start to the year, and here are some of the highlights. We're very pleased with the strong, robust organic growth story in the first quarter of 8%, focused on the tight cost controls and surgical price actions across our entire Company, which enabled an excellent Q1 operating leverage in the face of \$50 million of currency headwinds.

Security took another positive step forward on its multi-year transformation, with 2% organic growth, and year-over-year profit growth. And then finally, because of our confidence in our free cash flow outlook, we were able to accelerate our share repurchase program, which means we've really completed \$900 million of our program since the fourth quarter of last year, and the program that we announced back in the end of 2013.

Our operational focus in 2015 will continue to be on improving near-term returns and the relative performance of our Company through organic growth initiatives, a Security margin improvement, and stability and continued growth organically, cost and pricing actions, and of course, our ongoing working capital focus. We believe this approach was very successful in 2014, and again here in the first quarter. And we will continue this focus for the remainder of 2015 and beyond, as it does position our Company to deliver on the long-term financial objectives that we've established.

That concludes the presentation portion of our call. Now let's move to Q and A.

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

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

QUESTIONS AND ANSWERS

Operator

Thank you. I'll begin the question and answer session.

(Operator Instructions)

Our first question is from Jeff Sprague from Vertical Research.

Jeff Sprague - *Vertical Research - Analyst*

Thank you very much, gentlemen. You made a very busy day a little easier here today. I have one question, really, on your cost actions. And kind of thinking about the holistic nature of them, and really the nature of my question is, these offsetting actions you are taking, would you view them all as structural and permanent? Or should we expect some of this to kind of come back the other way as perhaps the FX pressures hopefully wane at some point in the future? If you could give us a little context around that, I think it would be very helpful. Thank you.

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

Absolutely. So we kind of embarked on this journey of cost actions in a more significant way about a year and a half, two years ago, and one of our main objectives was to take actions that were permanent in nature and not temporary that would result in some type of snapback of costs in the future. We've been targeting areas such as indirect spend which is basically all costs that are non-people related and putting forth policy changes, structural changes, procurement changes, et cetera, that are driving a lot of those benefits. And they are permanent changes that we expect to be maintained over the long term.

The other thing that we've done is we've taken specific head count restructuring actions related to the combination of our CDIY and IAR business for Tools and Storage. We've taken some corporate head count actions as well as some of our other businesses that are more surgical in nature, that allow us to really continue to focus on productivity and driving a more efficient P&L. Because of this approach and these different types of

actions, it really gives us confidence that it's not of the nature that we're just pushing down costs on a temporary basis, and we will experience some snapback in the future.

Operator

And our next question is from Rich Kwas from Wells Fargo.

Rich Kwas - *Wells Fargo Securities, LLC - Analyst*

Good morning, gentlemen. In terms of the competitive environment with regards to currency, any changes you've noticed here in the US with competitive actions from foreign-based entities? And then quick follow-up, hedging activity for 2016, Don, does this leave you in a position where you're going to still get hit in 2016 unless you put incremental hedges in? How should we think about that as we look forward here? Thank you.

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

Yes. I'll take the latter one first. So, you know -- as I mentioned, we've done a lot of hedging activities specifically around the euro and the Canadian dollar. The benefit we're getting for that here in 2015, or the neutralization I guess of currency is about \$70 million. And so that would be an impact that we would see in 2016.

We'll also have a modest carryover impact by some of the recent currency movements we've seen. So we think going into next year there's about \$100 million headwind for currency that some of which are focused on how we deal with through hedging activities, but we're also focused on what cost actions we can take as we go into 2016 to offset that impact as well, similar to what we've done over the last two years. We're going to take a very similar approach to that as we embark into 2016 as well. Jim, maybe you want to answer the comment --

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

On the competitive environment in the US and whether there have been any changes related to the FX dislocation that's occurred. Most, in fact, all of our major competitors have global footprints that are relatively similar. Our major European-based competitor has a little bit more European footprint in terms of supply chain, and our major Japanese competitor has a little bit more in Japan. But we all have a lot in China and in Mexico and other low-cost areas around the world.

So there really isn't a major structural change to the cost competitiveness that is created by the dislocation. I think we're -- all competitors are responding, as you might expect, which is in the emerging markets where we're shipping into those markets from dollar stable kind of -- or dollar, like Chinese or dollar denominated supply chains. There's a fair amount of price appreciation going on to offset -- partially offset -- the currency impact, and then the US is always brutally competitive and continues to be brutally competitive.

Operator

Our next question is from David McGregor from Longbow research.

David MacGregor - *Longbow Research - Analyst*

Yes. Good morning, congratulations on a great quarter and all the progress. I guess the CDIY, your incremental margins were substantially larger than I'd expected and obviously there's an awful lot going on in that segment right now. But I guess the question is just how much of this is from the combination of the IAR business and are these contribution margins expected to sustain through the rest of the year?



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

Yes David, very fair question. There are cost benefits to the combination in the IAR business. They're quite small relative to the volume leverage, particularly the advantage of a prolific new product development process that really was founded or grounded in our CDIY business that's now incorporating IAR.

So roughly three-quarters -- two-thirds of the benefit and ability to maintain margins is due to the volume leverage, new products at incremental margins and only a small portion would be due to the -- there are some cost benefits, but that is truly the icing on the cake rather than the driver for putting these two businesses together.

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

But as far as the impact in the quarter or in the past couple quarters, it's been nil. This is just getting going. So, the impact that John just described is yet to come.

Operator

Our next question is from Robert Barry from Susquehanna. Please go ahead.

Robert Barry - *Susquehanna Financial Group - Analyst*

Good morning. Congrats on a very solid quarter. Wanted to just talk a little more about the organic growth outlook, you raised it by 1 to 2 points and wanted to clarify how much of that is stronger end markets versus better momentum on your own initiatives? And to the extent that it's the markets, where are you seeing any incremental strength or weakness?

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

Yes. I'll take a shot at that, and I'll certainly ask Jim or Don to chime in. It is overwhelmingly share gains in our case. 50% of our revenue roughly is in the US. Those markets are slightly stronger than we'd anticipate, but you saw our Global Tools and Storage business up 12% in the quarter. So there's significant share gain there.

Europe, as I said in my piece of the presentation, globally, the markets are up 2% at best, some estimates are flat and we're up 6%. So, again, it's easily 3X the market growth rate, and our Tools and Storage business up more than that, so again, share gains. I think the wildcard is in the emerging markets which collectively represent about 20% of our revenue. They are up, but at a much lower rate, as Jim mentioned in his piece of the presentation.

Certain markets like China and Russia are down, but in total, the emerging markets are growing at low-single digits, and so are we. So simply said, the overwhelming majority of what you've seen in our numbers is share gain and, again, it's focused in our Global Tools and Storage business and our Engineered Fastening business.

Operator

Our next question is from Nigel Coe from Morgan Stanley.



Mike Sang - Morgan Stanley - Analyst

Hey, good morning, guys. It's actually Mike Sang in for Nigel. I didn't see capital deployment guidance and I apologize if you talked about it, but you didn't change your free cash guidance but to the extent you do better on free cash this year, how should we think about where you'll spend that incremental upside?

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

This is Don. We didn't specifically give guidance related to capital deployment. What we have said about this year though, is our primary objective was to complete our program of up to \$1 billion of share repurchase and you could argue that we've pretty much done that with \$900 million of it completed at this point in time.

We also have said that we have kind of opened up our -- reopened our funnel of BD opportunities over the last six months or so and we're evaluating different things and we may have some type of small acquisition later in the year of modest size. But, that's really about what the plan is at this stage and we feel good about where we are. If we outperform our cash flow, we'll have to evaluate the timing of that and what makes sense based on what's happening in BD as well as what our stock is trading at that point in time.

Operator

Our next question is from Mike Dahl from Credit Suisse.

Mike Dahl - Credit Suisse - Analyst

Hi, thanks. And quite a nice quarter, again, some pretty challenging conditions with the FX side. I wanted to go back to one of the prior comments on walking around the regions, John, I think you've been clear that some of these European comps, a lot of it's been driven by some tremendous share growth and new product innovation.

What's the expectation as far as -- I know you mentioned that you think it'll moderate, but has the continued strength caused you to kind of push out your expectation for how long you can keep a four or five point premium to the market growth on that side of the business?

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

Sure. I'm going to have Jim walk you through that, but, remember, we've got a stated objective of growing at 2X the rate of the market and we've been doing a pretty good job in our Global Tools and Storage business. But, Jim, I know you want to shed some more light on that.

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

It's a great question because the comps are -- we're comping against two years of organic growth in the tool business that's averaging about 7% per quarter. So when you look at the market growth and you look at that, you say how long can this go on? It's a very fair question.

But I would say that the team in Europe -- European tools in particular, but also in Engineering Fastening, those two management teams are really, really growth oriented teams and the ability to gain share is not constrained necessarily by structural conditions. So if they keep executing at that level, then I think they will be in that 4% to 6% range for a while. And the other thing about Europe is even though the markets haven't picked up, the optimism in Europe is palpably higher if you talk to business people in Europe. There's a lot of hope I guess is the best phrase or word I can think of. But not necessarily with our people, but when you just talk to people in general in Europe, there's a sentiment, a more positive sentiment than we've seen in a long, long time.

So that may actually help with the market and may over time push the market up a few points and certainly that would be helpful as well. But the reality of tough, difficult comps is a real one, and it's one where we don't necessarily push our expectations for organic growth much higher than say 4% to 6%. I think achieving that 2X market growth is something that we can continue to do for a while.

Operator

Our next question is from Jeff Kessler from Imperial Capital.

Jeff Kessler - Imperial Capital - Analyst

Yes. Not to steal the thunder from Investor Day, but could you go over -- be a little bit more specific as to the four parts of SFS 2 and how they impacted the first quarter, how you expect them to impact the year? What are -- specifically what are they going to do, and number two, put some numbers to that, flesh it out?

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

Sure. That's kind of like investor day, but I'll give you a quick snapshot.

Jeff Kessler - Imperial Capital - Analyst

That's all I want.

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

The four initiatives: digital excellence, breakthrough innovation, commercial excellence and functional transformation. We'll start with functional transformation is an approach that we're taking to reduce the cost of our staff functions, if you will, and so increase their efficiency while maintaining their effectiveness, which is very high. The functional transformation will yield benefits over a multi-year period, but really, at the moment we're investing in this, so there's an actual expense related to it in the quarter and we'll get into that at the Investor Day.

The other three are intended to drive growth, and they all require some investment, but the functional transformation is a way to fund that investment without affecting our day-to-day operations in a negative way. Digital excellence, we are doing a fair amount of work in that area to prioritize where we're going to make our investments, so there's not really any revenue impact from that at this point in time. There's some expense associated with that.

I think the one that has the most near-term impact is commercial excellence. Because commercial excellence includes several different elements, but one of those elements is pricing effectiveness and probably have noticed over the last year or so that we've been averaging about a point in price as a company, and that is about a point higher than we had been doing historically. And I would say virtually -- well, a large portion of that differential impact is associated with the commercial excellence initiative. There are many other parts to it.

I think I used the term commercial excellence several times when I was discussing the CDI -- or the Global Tools business and they have really taken commercial excellence and each element of it and deployed it within that business to achieve some of their differentiated performance in share gain. They can do even more with commercial excellence and the rest of the Company can really do a lot more with that, so that's what we expect to see in the future.

And the final one, it's important to differentiate between what I'll call incremental innovation or day-to-day innovation which I think we and our competitors all do reasonably well. We have things like -- a good example of that would be the DC brushless innovation that we've done recently



and the share gain we've received through that. The breakthrough innovation is basically taking -- going beyond incremental innovation and really looking for those breakthroughs that can change the whole competitive framework of the industry and give us a competitive advantage.

And so we have studied companies in the best pockets of breakthrough innovation in the world, primarily in the US, and we have deployed some of the practices that you'll see in the Valley and so forth, and we're doing some experimentation with that and we're hopeful that we can create some breakthrough innovations. In the meantime we're going full speed ahead with our normal incremental innovation and the incremental innovation is really what's driving the share gain and one of the things that's driving the share gain in the tools business today. So that's a quick snapshot. There's plenty more to come on May 15.

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

Yes. And, Jeff, let me tie that up in a bow without -- and Jim, I think, did a very nice job of not stealing our own thunder for Investor Day. We've got a lot to communicate and we want to communicate it very coherently and systematically all in the same place.

But SFS 1.0, if you'd like, was focused on operational excellence. We think we've done a very, very good job in working capital turns have doubled as a result of that, eliminate waste, eliminate complexity unless it adds a benefit that the customer is willing to pay for and so forth. You've heard us talk about it a lot.

We think we've gotten it down. We've been at it about eight years and we think it truly, truly is embedded in the DNA of this Company. What Jim described is an effort in terms of when will the benefits come? We're paying as we go and I think Jim described that perfectly in terms of we're investing and getting a little bit of benefit. The future benefits will come well down the road just like they have with SFS.

But importantly, it is all designed to embed a growth culture, first establish and embed a growth culture within the Company. If we look at all our long-term objectives, we've done a really good job meeting or exceeding all of them, with the exception of organic growth where over the years we've been at 3% to 4% which has been about the industry average, about our competitors' average, peer group average.

Of late we've step that up due to some phenomenal results from the incremental growth platforms and programs that Jim described. Long term, we're looking to drive that up and just embed it into our culture and have it become equally as important in our DNA as we think running our operations effectively and efficiently has become.

Operator

Our next question is from Jeremie Capron from CLSA.

Jeremie Capron - *CLSA - Analyst*

Thanks, and good morning. I wanted to follow up on your commentary on pricing. You had a full point of price gains in the quarter, and you sounded pretty dismissive in terms of any deterioration in the pricing environment globally, yet we're seeing a peeled down gain in commodity prices. My question really is how sustainable do you think your price gains are for the remainder of the year and what sort of dynamics are you seeing in terms of your price / cost. It looks like a nice tailwind here.

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

Sure. I'll take that one. Yes, we were very pleased, as John mentioned, with our price performance in Q1. We talked about price as a Company on and off over the last decade several times. But in the last year, year and a half we've really put a significant emphasis on gaining price in different ways across many of our businesses.

It's not always just about list price, it's about other types of activities that happened with your customers and really trying to drive the maximum value associated with the product or the service that you're providing to your customer. And that emphasis has not changed. There has been a new dynamic, as you mentioned, in the last six months or so where commodities have moved in certain direction, it's been a benefit to companies like us.

The reality for us is the number is not overly significant. We touched on it briefly back in January. It's roughly \$50 million of benefit for us on an annualized basis. At this point in time we continue to evaluate that as we go into next year and see what other opportunities we have. But it's not really large enough to drive a significant pricing discussion across an \$11 billion enterprise like our Company. If that dynamic ever changes, then we could potentially have the circumstances that you described and we have gone through those cycles.

But we have put significant routines and processes in place around pricing to really deal with these types of dynamics and make sure that we understand the levels of profitability that we're achieving on key products, especially what we call our A products and services that we provide and I don't expect that focus to change. I actually expect it to accelerate and become more mature over time.

Operator

Our next question is from Liam Burke from Wunderlich, please go ahead.

Liam Burke - *Wunderlich Securities, Inc. - Analyst*

Thank you. Your growth domestically on tools and storage was pretty strong. You have bought back manufacturing to the US. Has that program helped drive organic sales growth and do you plan on adding more capacity in the US?

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

Yes, Liam, I'll take it. The answer is absolutely yes. Yes and yes, simply said. We knew -- it's turned out to be not a terrific hitch in terms of production costs because when we first brought this production back, we had total delivered product costs, obviously we took a lot of product off the water in time and improved our working capital turns. We had costs within flat to 5% and we're driving that down towards cost neutral relative to some of the low-cost countries. It's probably not a parity now given the strength of the dollar.

We knew it was a good thing to do in terms of supply chain, satisfying our customers, keeping fill rates above 98%. We underestimated the positive impact, customer reaction particularly in the industrial distribution channel and that's what we call the two-step channel of the -- quite frankly the loyalty it created, the incredibly positive reaction from professional contractors and folks working in manufacturing facilities around the country. So we're very pleased with not only our ability to get the facilities up and running, we're very pleased with -- we're delighted by the customer reaction.

As a consequence, we're looking at two other opportunities near term in the US, and again, it's not going to be a step function shift, but it'll be a gradual shift to expand two existing US facilities to produce more of our core products sold primarily in the US in those markets, and we -- more to come on that when it happens. We can't get ahead of ourselves in terms of our own work force and our planning and various negotiations that are currently in process. But there is more to come. As I say, it will not be gigantic, but it'll be incremental or an evolution versus a revolution, but based on the results to date, there's -- we've got all -- we've got a lot of good reasons, qualitatively and quantitatively to do some more of this in the next 6 to 18 months.

Operator

Our next question is from Michael Rehaut from JPMorgan. Go ahead, Michael with your question.



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

Mike, are you on mute? Move to the next one, please.

Operator

Our next question is from Dennis McGill from Zelman and Associates.

Dennis McGill - *Zelman & Associates - Analyst*

Good morning, thank you. I just want to go back to an earlier question on the margin performance in the first quarter and the new Tools and Storage business. If you look year over year, that incremental margin being over 70%, and I think you talked to for the full year some of the drivers that are plus or minus. But was just hoping maybe you can talk to specific in the quarter what the drivers were there and then how you think some of those drivers progress as you move through the year.

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

Sure. We can touch on that, as we touched on, obviously we saw significant operating leverage through the organic growth. We also are seeing really solid benefits from an SG&A actions that I mentioned around indirect costs. We've seen some good pricing initiatives that dropped through all the way to the bottom line. It's a combination of all those factors and, of course, there's also a little bit of commodity deflation occurring as well that's beneficial to this particular business.

Combining that with the fact that I mentioned at the beginning which is organic growth. You have a high level of activity happening in our plants that occur because of high organic growth in Q1 and expected high organic growth in Q2, well above what we experienced in the first half or the first quarter of last year. So there's certainly a leverage effect that's even greater than you would normally see because of organic growth numbers that are basically double digit.

Operator

And I'll now turn it back over to Greg for closing remarks.

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

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

Operator

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



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