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SWK - Q2 2014 Stanley Black & Decker Inc Earnings Call

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OVERVIEW:

Co. reported 2Q14 diluted EPS of $1.43. Expects 2014 GAAP EPS to be $5.38-5.48 and EPS to be $5.50-5.60.

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PRESENTATION

Operator

Welcome to the Q2 2014 Stanley Black & Decker Incorporated earnings conference call. My name is Paulette, and I will be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded. I will now turn the call over to the Vice President of Investor and Government Relations, Greg Waybright. Mr. Waybright, you may begin.

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

Thank you, Paulette. Good morning, everyone, and thank you for joining us for Stanley Black & Decker's second-quarter 2014 conference call. On the call, in addition to myself, is John Lundgren Chairman and CEO; Jim Loree, President and COO; and Don Allan, Senior Vice President and CFO.

Our earnings release, which was issued earlier this morning, and a supplemental presentation which we will refer to during the call are available on the IR portion of our website, as well as on our iPhone and iPad app. 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 Stanley's second-quarter 2014 results and various other matters, followed by a Q&A session. Because of the size of the queue, we are going to be sticking with just one question per caller.

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 uncertainties. 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 and the 8-K that we filed with our press release, and in our most recent 34 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 thank you, Paulette. Thanks to those of you listening in this morning for our second-quarter call.

During the second quarter, our organic growth of 1% was negatively impacted by the shortened North American outdoor product season, as well as some volatility and slower growth in emerging markets. Each of those two factors was worth about $25 million in revenue, or 100 basis points, for a total of about 2 percentage points of growth, the combination of those two factors. This being said, our sharp cost focus on price realization delivered some healthy gross as well as operating margin expansion, despite some significant currency pressure.

Currency was about a $20 million headwind of the second quarter, and that was in line with our expectations. And as you'll recall, it's slightly below the $25 million headwinds that we experienced during the first quarter, so about $45 million during the first half of the year thus far. Gross margin expanded 100 basis points versus prior-year to 36.5%, and operating margin expanded 110 basis points to 13.7%. Diluted EPS was up 17% versus prior-year to $1.43, and as the spread between reported and GAAP earnings narrows, that's $1.37 on a GAAP basis.

You are going to hear a lot more about segments in just a few minutes, but just a couple highlights of the segments. CDIY margin expanded to a post-Stanley Black & Decker merger record of 15.7%. Price, productivity, cost actions more than offset currency, and the previously-mentioned outdoor product headwinds.

Our Industrial segment delivered 3% organic growth, and a very strong 17% operating margin, which was up 260 basis points versus second-quarter 2013. Security North America and emerging markets organic growth was 2%, and their 16.5% operating margin was up 310 basis points versus prior-year, approaching the historical levels of profitability that that business had demonstrated its ability to achieve.

In Security Europe, our turnaround took a very positive step. Its operating margin was up 240 basis points sequentially.

So based on the segment results, and that performance, and the programs that we have in place in the second half of 2014, some of which you will hear a little bit more about today, we are going to increase our 2014 EPS guidance range, and we are reiterating our cash flow guidance. Specifically, an EPS range of $5.50 to $5.60 ex-charges, with at least $675 million of free cash flow, and that's inclusive of $250 million of one-time payments.

Turning to our sources of growth. On our first-quarter call, we communicated that we expected organic growth and total growth to decelerate modestly in the second quarter, based in part on prior-year organic growth comps at 6% and 9%, in CDIY and Industrial, respectively. And the additional adverse impacts of the outdoor product softness in the emerging market volatility resulted in total organic growth of 1%.

And there was no incremental growth via acquisitions, in the quarter. All of which is depicted in the chart that's projected on the left.

In terms of the regions, the US remains healthy, as POS exceeded shipments, excluding outdoor, across the board. CDIY share gains in Europe, as well as solid performance in Industrial, was partially offset by Security Europe volume softness. And it was a rocky and volatile road in emerging markets, with geopolitical issues in Venezuela, Russia, currency in Brazil, all having impacts.

But this being said, we remain quite optimistic, based on the strength and the efficacy of our mid-product price range, early indications are very good. Jim will talk a little bit more about that in just a minute or so.

And in the gray area, you see a shaded portion called "Emerging Market Organization". The reason we have differentiated that, and we've shown the plus 3% in the second quarter versus the 1%, is our emerging market organization, this is the area of the group of products and people in markets where we have focused our organic growth initiatives. And specifically, it excludes Engineered Fastening and our Hydraulics and CRC infrastructure businesses. So I think it's worthy of note that where we have focused and targeted the incremental investments that drive organic growth, despite the market headwinds, we did achieve 3% in the second quarter.

Let me turn it over to Jim, who is going to do a deeper dive into some of the segments. Don is going to follow that with some guidance and a look at the cash flow.

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

Okay, thank you, John. Starting with CDIY, it was an impressive quarter for margin expansion, with the post-merger record of 15.7% achieved in the face of flat organic revenue growth, an outcome which was about 4 points lower than expected organically for CDIY, due to the weak outdoor product season and unusually volatile emerging market conditions that John referenced.

But we were able to absorb these two transitory growth issues in CDIY during the quarter while handily beating consensus and upgrading our total-year estimate is a testament to the underlying earnings power of the Company. Even more encouraging, the outlook for CDIY organic growth in the second half is strong, with the resumption of mid single-digit growth, and the attendant operating leverage that goes with it.

I will now address the two second-quarter CDIY growth governors in a bit more detail. First, outdoor products.

Some of you will recall that last year, the outdoor season sell-in was delayed in 1Q, most notably in March, due to cold weather, causing us a CDIY growth issue in the first quarter of 2013. The second quarter of 2013 proceeded normally, but the season got off to a late start, and in total, was relatively soft, based on historical norms.

Given the easy comp this year, the big four retailers in the aggregate were relatively optimistic in first quarter about the overall season, despite the unwelcome cold weather conditions at the time. Plus, orders and sell-in were both good in 1Q 2014 against an easy comp for us, so no issue. However, as the cold weather persisted into second quarter, retailers' sentiment regarding the season quickly grew pessimistic, and replenishments virtually ceased, as they attempted to liquidate their high inventories of outdoor product.

So instead of an outdoor quarter, which was expected to be up in the high single digits, right around 10%, we ended up with one that was down about 15%, which cost us 2 points of year-over-year growth in CDIY. That is now behind us.

The other growth challenge in the quarter, emerging markets, was simply one of unusually high volatility in the face of gradually slowing markets. It was a quarter in which Latin America, about half of our emerging markets, tool business grew only 2%, with Brazil slightly negative, as the World Cup became a huge market distraction, and with zero sales in Venezuela, once again.

The other half of the emerging markets portfolio was impacted by Russia and Turkey, which were down 16% and 30% respectively. China was also quite slow.

All indications are that the second half will be stronger for both tools in emerging markets, with our major NPI foray into mid-price-point power tools and hand tools hitting the market across the geographies, as we speak. The Venezuela sales drag anniversarying in September, and the outlook for Brazil and China looking modestly better.

Now, moving to a very bright spot in the second quarter organic performance: Europe. We couldn't be happier with the progress that the CDIY team is making there, with organic growth up 7%, representing a five quarter streak with growth averaging 6% in one of the more tepid economic regions among the developed markets.

This represents clear market share gains, stemming from both new listings at retailers and distributors, as well as a deluge of NPI, including great success with the XR brushless cordless product, as well as multi-tools and steam products. Our four major product categories, professional power tools, consumer products, hand tools, and storage and fastening assembly, each averaged 500 new distribution outlets on a year-over-year basis.

So as we step back from the CDIY picture, we see a very healthy franchise with world-leading brands, broad and deep global distribution, delivering record margins during a quarter in which organic growth was suppressed by few unusual items. And as we look forward, we have tremendous NPI momentum in both developed and developing markets, and a cost structure that is poised for operating leverage.

Turning to Industrial. Industrial this quarter once again hit on all cylinders, and demonstrated the kind of operating leverage that is achievable with a few points of organic growth. In this case, 3 points of organic growth and a point from acquisitions yielded 22% growth in operating margin.

The margin rate came in at 17.0%, up 260 basis points versus a year ago, as price, productivity, SG&A control, and volume all contributed to the performance. Both Industrial and Automotive Repair, or IAR, and Engineered Fastening, developed strong OM growth, up 22% and 18% respectively.

For IAR, organic growth of 2% was a mixed bag across geographies. North America was solid at 6%, with strong performances from Mac Tools, industrial distribution, engineered storage, and advanced industrial solutions. Europe was off 3 points, primarily as a result of timing related to an ERP project, and emerging markets were up a point, the latter impacted by the same type of market issues as CDIY.

Engineered Fastening was also up 2% organically, with automotive up 9%, significantly outpacing global light vehicle production, which was up 2%. And the industrial portion of Engineered Fastening was down 2%, with timing of sales to electronics OEMs weighing down a strong performance in industrial distribution. Infrastructure was up 5% organically, with Oil and Gas up 4%, and Hydraulics up 9%. In total, it was an excellent quarter for the Industrial portfolio, and we can expect continued momentum to carry into the second half.

Moving to Security, this was a quarter in which the financials began to reflect the underlying progress which has been made in both North America and Europe over the last nine months or so. Revenues were flat, with organic growth down a point, operating margin up 8% year-over-year, recovering to 11.3%, and up 80 basis points. North America and emerging markets was up 2% organically, with Europe down 6%. North America and emerging markets OM was up 310 basis points versus a year ago, approaching very healthy historical norms at 16.5% of sales benefiting from volume, better pricing, field efficiency, and a tight SG&A framework.

In North America, vertical market penetration continued to grow, with a series of large exciting wins in retail, financial services, and higher education. Europe was characterized by improved stability and predictability, as many of the operational and organizational fixes discussed over the last few quarters began to produce results. In that regard, Europe performed in accordance with expectations, with OM still in the low single digits, but improving sequentially by 240 basis points, and setting the stage for continued improvement in the second half.

Of the 14 country P&Ls in Europe, 12 are now considered stable or improving, and only two, Spain and Italy, representing 10% of the portfolio, the European portfolio, are still facing significant structural and operational headwinds. On a very positive note, Europe attrition is tracking to our targeted range of 10% to 12%, about 700 basis points favorable to last year. Our focus in Europe continues to be on tight operational management, and cost reductions, to drive margin expansion and ultimately organic growth. So while Security is still a work in progress, especially in Europe, we are quite confident that we are on the right track, and the results we continue to improve as we go forward.

With that, I will turn it over to Don Allan for some commentary on the financials.

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

Thank you, Jim. I'd like to spend a little time talking about our cash flow performance this morning. We are very pleased with our second-quarter free cash flow of $376 million, as the earnings growth and lower one-time payments resulted in this excellent performance.

And you can see, as you look at the second quarter versus the prior year, in the line Other, there's a significant benefit, and that's being driven by these lower one-time payments in a significant way. As we have begun to wind down these activities, as discussed back in the late part of 2013, and began to execute that throughout the early stages of 2014, and are very pleased with that result.

Moving to the right side of the page, looking at our year-to-date performance, you can see that we still have a very significant working capital negative outflow. That was planned and expected, our working capital terms are at 6.7 times, right in line with our expectations. We still have plans in place to achieve a goal of somewhere between 8.5 and 9 turns by the end of the year, and we feel very good about those plans, and the ability to execute on them in the next six months.

Another item of note is our CapEx. As you know, we've been very focused on controlling the level of CapEx, getting ourselves with any band of 2% to 2.5% of our revenue. And through the first six months of the year, we're at 2.15% of revenue, so very pleased with that as well.

Looking at free cash flow in total through the first six months, $166 million. If you look at the history of our Company, post merger of Stanley and Black & Decker, historical trends would say that roughly 24% to 25% of our free cash flow happens in the first half of the year. And just extrapolating that would give you an indication that our goal of $675 million is very much achievable.

The other thing to factor in, though, is we are very much focused on controlling CapEx, controlling the one-time payments. And we feel very comfortable that our plans are related to working capital, which gives us the confidence that we have the ability to at least achieve $675 million cash flow for this year.

Moving to guidance on the next page, I obviously touched on cash flow over the last few minutes, but let's spend a little bit more time on EPS. As John mentioned, we increased our guidance range for 2014 for EPS to $5.50 up to $5.60, from the previous range of $5.35 to $5.50. On a GAAP basis, the range is up the same amount of factor to $5.38 to $5.48, so the difference between GAAP and adjusted is roughly $0.12, which approximates the $25 million of charges that we anticipated since the beginning of the year, so no change there.

What is driving this change in guidance? It's really three factors. The first is that we do expect our organic growth to be a bit lower as emerging markets is experiencing some volatility, that Jim walked through in a fair amount of detail.

Although things will get better in the back half of the year, we do expect the full year to be slightly lower versus previous expectations. The outdoor season has been shortened, and obviously that has an impact on the full year as well. So as a result, we believe organic growth, where we originally thought of approximately 4%, would be somewhere between 3% and 4%, so a modest decline in organic growth, versus prior expectations.

More than offsetting this impact, however, is a much stronger performance in our Industrial business, and a very strong performance across the entire Company, related to lower indirect costs as well as pricing benefits, as we continue to focus on really programming the Company to be prepared for certain volatility in the top line, which is -- most likely will occur. And then, the last factor that's changing is we will be lowering our tax rate to the bottom of the range, where we gave an initial range earlier in the year of 21% to 22%. We expect that to be closer to 21%, however we do expect a little bit of share creep, and those two items will neutralize themselves.

Two other factors to note, related to guidance. I mentioned this factor back in April, that if you look at the Company post merger for the last three or four years, our earnings have been split from first half and second half approximately 45% to 55%. When you do the math, you will see the new guidance range indicates that is consistent with these trends. And so we feel comfortable with that expectation, as well.

And then looking at the second half earning split versus the third quarter and the fourth quarter, we would expect 47% and 53% respectively, as we do see some timing issues related to tax that will show some positive benefits in the fourth quarter versus the third quarter. And then, as we continue to accelerate these indirect cost benefits and pricing benefits, that will have a more positive impact in the fourth quarter versus the third quarter.

And lastly, a little bit of flavor on the segments over to the right. You can see that our CDIY and Industrial segments continue to be consistent. We expect mid-single-digit organic growth in both segments. Margin rate year-over-year improvement, as the operating margin rate continues to increase due to some volume leverage, cost actions, and those items are more than offsetting the negative FX that John walked through in a little detail earlier on.

In Security, we expect a flat to modest decrease in organic revenue, consistent with prior expectations, and the margin rate to be relatively flat. So no major change with the outlook associated with Security. We feel like we have programmed the Company to be prepared for a little bit of volatility associated with some of the economic and market conditions around the world, by really focusing on indirect cost and certain pricing actions, and it positions us well to achieve our new guidance range.

So to summarize the call this morning, 2014 continues to be focused on executing operating and capital allocation actions. We have delivered a very strong second-quarter performance, despite some significant weather issues, foreign currency pressures, and emerging market volatility. We were able to demonstrate margin expansion across all our segments. We have a very tight cost focus across the entire enterprise, which enabled significant operating leverage. We remain optimistic about the security European recovery, and we feel like the second quarter was a very positive step forward.

We remain focused on our 2014 near-term items, which is really to make sure that we are focused on the returns and relative performance of the Company. And we are focused on organic growth initiatives, the continued Security margin improvement, surgical cost actions across the entire Company to ensure we continue to achieve operating leverage, not losing sight of our working capital focus in achieving 8.5 to 9 working terms by the end of the year.

And then of course, making sure that we continue to stay on track with our capital allocation re-balance for 2014 and 2015, with an acquisition moratorium. And then share repurchase and deleverage, as we continue this year, and into 2015. All of these items, we believe, position us very well, to make sure that we deliver our long-term financial objectives.

With that, we will move to Q&A.

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

Great, Don. Thank you. Paulette, we can now open the call to Q&A, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Mike Dahl from Credit Suisse.

Michael Dahl - *Credit Suisse - Analyst*

With respect to the margins, really impressive job on CDIY, this quarter hitting a new record. I was wondering, you highlighted a bunch of things, but given that the mix of geographies and products shifted a bit, could you quantify, and of how much that also may have helped, and how you think about margins longer-term in this segment, given how far you've come? Thanks.

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

I think one of the great misperceptions about the CDIY business or any of our businesses is that, as you go across the globe, we have radically different profitability structures. And while the gross margins and the SG&A can be somewhat different, as you go from geography to geography, typically the operating margins are very consistent.

So the mix of, for instance, the lower emerging markets, did not have a dramatic positive impact on the operating margin. The extra good performance in Europe vis-a-vis say the US with its outdoor issues, did not have a significant impact on operating margins from a mix perspective. So really, the geographic mix, in general, is not a big deal, in terms of driving the margin rate.

What really drove it was a series of things that both Don, and actually, all three of us talked about. Which is a really, really tight focus on margin management starting with gross margins, productivity in the factories through the Stanley Fulfillment System, pricing, and new product introduction driving competency in the organization in terms of pricing -- price management.

And then on the cost side, in SG&A we have really -- as you know we took several actions last year that are now carrying over into this year as planned, but on top of that, we've had a very sharp focus on indirect cost reduction across the Company. We spend over $1 billion a year of cost in this indirect area, which would be the non-people related expenses.

And every dollar of that today is under a microscope as to whether it's really driving revenue, driving value, and whether it can be reduced without hurting anything related to the Company's overall growth and profitability. That is what drove the margin improvement, and not a mix impact.

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

Let me add one point, and just even further amplify what Jim said because you asked basically, about geographic mix, and I think Jim described that in quite accurate detail. They are consistent. He didn't talk specifically about product mix.

Historically, hand tools and storage have been slightly higher profitability than power tools. This being said, the team has made great progress on power tool margins, with some of its design and engineering efforts. And this particular quarter, you will note from Jim's deep dive on the segments, power tools was up 2%, while hand tools and storage was flat.

So if anything, it's a negative product mix in the quarter, more than offset by the initiatives that Jim just talked about. So there's a lot of good things going on within the four walls of our CDIY business, and Jim described them quite accurately.

Operator

Our next question comes from Stephen Kim from Barclays.

Stephen Kim - *Barclays Capital - Analyst*

A lot of encouraging things today. I guess I wanted to follow-up here on CDIY. I think you are looking for a mid-single-digit organic growth as we go forward.

Obviously, the broader context in things housing-related has gotten softer of late, it sounds, both on the remodeling as well as on the new construction side. You called out outdoor, which makes a lot of sense, due to the weather.

But I was curious if you could provide a little more granularity around what your expectations are for a shift in back half, things getting stronger, and if you could get some granularity, particularly you made mention, I think, that hand tools and storage was flat in the quarter. I was wondering whether you think any of that maybe reflects some of the softness that was referring to in the broader housing context, and what international or emerging markets expectations you got embedded in that mid-single digit CDIY outlook? Thanks.

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

Sure Steve. It's pretty simple. The North American POS was 6% in the quarter. It was up sequentially versus the first quarter, so we didn't see any softening in our POS in North America.

And we continue to, as we forecast POS on a go-forward basis, continue to see strong performance in whatever market conditions we happen to be in right now, which don't appear to be slowing from our perspective. And that's partially because, as you know, we are not directly tied to the housing market, we're indirectly tied to the housing market.

In Europe, we continue to see strong performance, based on the product introductions that I referenced, and the outlets that were increased, so we can expect continued mid-single digits there. And in the emerging markets, we were up 5% in the first half and we expect to be up at least that much in the back half, and potentially more based on a tremendous, as I said in my comments, new product introduction in the mid-price point product.

That's not to be underestimated. That is a significant initiative that's been in the works for about a year and a half now, almost two years, and the products are literally being sold as we speak.

That will drive under whatever geopolitical situation that we have, as we sit here today. That will drive outperformance under those circumstances, so we're quite confident about the mid-single digits in CDIY in the back half.

Operator

Our next question comes from Mike Wood from Macquarie.

Mike Wood - *Macquarie Research - Analyst*

In terms of the European Security business, is any of the resizing of the business there incremental, based on the organic growth weakness in southern Europe? And at this new resized level, can you talk about much longer term, where the structural margin range is for that European conversion Security business?

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

Obviously we talked to the European Security business in the sense of how much sequential improvement it made year over year, I'm sorry, quarter over quarter. Very pleased with that.

We're not seeing incremental improvement yet in the second quarter versus the prior year. And our expectation is, as we go through the remainder of the year, and we get closer to the fourth quarter, then at that point we can see some year over year improvement in the business performance.

Now that's really going to be dependent on a couple factors. One, we are seeing some difficult performance, as Jim mentioned, in Spain and Italy.

When you exclude those two countries, you will most likely see a healthy performance year over year in this business, excluding those two countries. But those two countries, right now, are weighing down the business a little bit.

Our expectation at this point is that we would expect some incremental improvement even with them, by the end of the year, but that could be a modest challenge for us. We factor that into our guidance, so we are not overly concerned about it. But when we look at that business specifically we do see that as a bit of a challenge.

As far as long-term, we still continue to believe that this is a business that can be double-digit profitability over the next few years, and then eventually, it can get to mid-teens levels, along with the rest of our security business. The factor that's really going to drive that second stage evolution is going to be what we've been doing in North America over the last 18 months or so, which has been rolling out the vertical market solutions, to key verticals such as retail, financial services, healthcare, et cetera, and bringing those to Europe because we haven't done that at this stage, because we're in a turnaround recovery mode of that business, getting all the basics in place, the operating rhythms, and the field organization structured the right way, et cetera, et cetera. By the end of the year early next year, we will begin to bring this vertical approach to the European marketplace, and as a result, that will help us move the profitability of this business closer to the mid-teens level over the long-term.

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

This is John. Let me add, because you won't get a follow-up. Don referenced Spain and Italy without too much cause-and-effect, but I think you all are quite familiar with what is going on, particularly in the Spanish market, which is a large market for us. Just three things to touch on.

First of all, a very intense competitive environment, which makes it a difficult market in the first place. Second, not news to anyone, commercial construction is non-existent in Spain, and has been for the last year and a half.

Thirdly, with the Niscayah acquisition, we were largely influenced by the financial services verticals, specifically banks. And it's probably not news to anyone that banks, particularly bank branches in Spain, are closing at a very, very rapid rate. So our business is -- we're fishing in a much smaller pond in an intense competitive environment than two years ago, and that is creating some headwinds for that business, that Don referenced to, but it is probably appropriate to give you just a little bit of the why.

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

But there is no cause for major concern because it's really, with less than 10% of our European portfolio, and less than 5% of our total security portfolio, but we're being very forthright in saying that we don't think we have solved the issue in Spain and Italy yet.

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

We factored it into our guidance.

Operator

Our next question comes from Nigel Coe for Morgan Stanley.

Mike Sang - *Morgan Stanley - Analyst*

It's actually Mike Sang in for Nigel. I want to jump back on the MPP initiative. It sounds like it's going well, and you alluded to it earlier, but against the backdrop of weaker emerging markets, I was wondering if that changes your view at all on how much you need to invest to build that business, and how that calculus impacts the top line and margin contributions long-term.

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

So just refresh everybody who may or may not have heard this in the past, but the MPP markets in tools, across the emerging markets, are about 60% to 70% of the total markets. And they are where the growth is the fastest, and they are where the local competitors are the most skilled at driving growth. So if you're going to play in tools on a serious global emerging market platform, you have to play in the MPP market, and you have to do it with products that are at the price point and at the performance point that you are meeting or exceeding the local competition.

So our strategy has been very much focused on exactly that, and it actually plays quite well into slowing markets, because slowing markets tend to have economic distress, and when economic distress occurs, people move from higher-priced products to lower-priced products, so we expect growth in the mid-price point, and we call it MPP-plus, which is midpoint price point plus, or MPP, or MPP minus. We even expect within MPP to see a little degradation from MPP plus to MPP, a waterfall down. In terms of where the market goes.

And I think we're extremely well positioned in that regard, and we made our investment. It's not like we have to make a lot of new investments. We put 300 feet on the street, we have designed the products. We have bought GQ, the Chinese power tool company. We've upgraded the products so they compete very nicely with the local Chinese leader in that market. They also export beautifully into all our markets around the world.

We're in a pretty good place there, and I think in addition to that, if the markets were accelerating, I suspect that the desire to invest amongst all the competitors would be even stronger. I think the likelihood of investments by competitors is still there, but perhaps the magnitude and speed at which they invest will be regulated somewhat by the market expectations. So in a perverse way, I think we're in a very good spot.

Operator

Our next question comes from Rich Kwas from Wells Fargo.

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

Two questions. Just one the first one, what is the organic growth rate that is assumed in the 3% to 4% rate for the year, in terms of the contribution from our organic growth initiatives?

And then second one, John, you talked about Spain and Italy being a pressure point within European Security. At what point do you start to look at that and say, do we really need to be there, and is that structurally important to our overall Security business, and it may make sense for us to move away from those markets longer-term?

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

The first one is just math, Rich, we're up 2% organically in the first half. If we're going to be up 3% in the second half of the year, the math would say we have to be 4%.

It's just math. 2 plus 4 divided by 2 is 3, so it's 4% to 5% in the second half. If that is your question, versus 2%. This is globally, of course, for the entire Corporation all-in, and obviously, that's going to vary by segment.

In the answer to your second question, very clever to sneak that in one breath, so you didn't get busted by the police. The answer is, that's a great question. We asked ourselves that question all the time.

We looked at all the alternatives and we will continue to. I think what's important to note is, before we abandon something, we give it our best effort to fix it. And we've made some tremendous improvements there. We will continue to do that.

But you are right on. We are not in a position on this call to talk about paths forward, but I think let's get realistic. Jim gave you a very important number. It's 10% of our European Security business, which means it is 5% of our global Security business, which means it's 1.25% of our Company.

We are looking at it, we're focusing on the alternatives. We are not going to move a lot of needles, irrespective of what we do, but to the extent it continues to be a drag. You have followed us a long time. We have a history of, if we can't fix something in 18 to 24 months, we usually do something else with it. And we don't fall in love with anything that isn't earning its cost of capital.

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

I think, Rich may have actually asked a third question, there too. He's looking for the growth initiative impact for the year. And that's about 1.5 points.

Operator

Our next question comes from Michael Rehaut from JPMorgan.

Will Wong - *JPMorgan Chase & Co. - Analyst*

It's actually Will Wong on for Mike. Part of the increase in operating EPS guidance you said was due to better Industrial performance expectations. Within Industrial, is there a specific area that's driving this outlook, or is it evenly spread each of the individual groups?

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

Within our Industrial segment, as you know, the largest business is our Industrial and Automotive Repair business, which are very large businesses in the US and Europe. Number one.

Our Engineered Fastening business, which is performing extremely well, and then our smaller businesses within the Industrial segment, as we report, are oil and gas and hydraulics. Each and every one is up beautifully year to date and we expect more good things.

Jim talked about how well Engineered Fastening was performing, but still 50% to 60% of the business is OEM auto, and it's performing at a level 4 times the rate of the market. So we're obviously gaining share. Well-managed business, diversifying into other verticals.

IAR is strong. And we think we will continue to be. IAR has a large percentage of its business in Europe, but it's performing quite well in Europe, despite a relatively stagnant market.

And Oil and Gas and Hydraulics being much more volatile had really nice second quarters, and we see those trends continuing. That's a very long way of saying there's strength across each and every business, within our Industrial segment and at the current point, there are no fixer-uppers, there's just leverage and great positive momentum that those business leaders have -- are taking into the second half of the year.

Operator

Our next question comes from Jeremie Capron from CLSA.

Jeremie Capron - *Credit Agricole Securities - Analyst*

Good progress on margins, and I wanted to follow up on the previous question on the Industrial segment, where we've seen over 200 BPs of margin expansion there. I'm wondering if you could give us more color on what's driving these margin expansion, and what we should expect going forward, as manufacturing activity seems to be expanding. Should we expect operating leverage to continue to play a large role there, and to see margins trending up further?

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

Sure, I'll take that one. I think John did a very good job answering that question. We clearly see that across the portfolio, within Industrial, all four components of it, if you want to look at that, which is really three ones we talk about externally, Infrastructure, IAR, and Engineered Fastening, are contributing in a positive way for organic growth, and contributing in a very positive way for operating leverage.

The reason they're contributing in such a significant way for operating leverage is all the things that all three of us articulated in a fair amount of detail this morning, which is, we're focused on surgical pricing actions, in all our businesses. We're focused on indirect cost controls.

We've also taken other SG&A cost actions that were embarked upon in the fourth quarter of last year. And we've been very focused on how we improve our operating leverage across our Company.

I think you are seeing the most significant impact within our Industrial segment, but then again, when you look at the rest of the company, you see it across CDIY and even in Security. It's really representing the impact of all the things that we're trying to do to manage the business, manage the organic growth, manage the margin mix, manage the price, manage the costs and really enhance the operating performance of the business, and ultimately the true cash flow of the business and the Company starts to come through, and you saw that in the second quarter with a very strong cash flow performance.

Operator

Our next question comes from Kenneth Zener from KeyBanc.

Kenneth Zener - *KeyBanc Capital Markets - Analyst*

John, I wonder if you could do the math for me. On U.S. Security margins split between CSS and mechanical, and expand on your comments on how the domestic field efficiencies are lifting the CSS business? Because I know there historically have been real spreads there. Seems like that's part is picking up, but mechanical is coming down. Thank you.

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

Yes. I won't do the specific math, because we don't necessarily want margin by sub-segment by sub-segment within a segment in the public domain. You know this business really well, but I think I can help you directionally.

Historically MAS, Mechanical Access Security, and access have had higher margins than convergent. That is converging, as electronic margins increase. We maintain or increase at a faster rate than either access or MAS.

Our MAS business is still a little soft, so it's representing a lower percentage of the total, due to no other factor than what Jim has talked about on several of the calls, specifically the switch from a direct to a distribution model and the resulting margin impact of that, which over time, we're highly confident will be offset by increased volume, by increased share, by operating leverage.

But as we speak, consistently high margins, there's no huge spread across the three sub-segments within North American Security. And as Jim referenced to a previous call, the Asia-Pacific or emerging market piece that's baked into that same number, there is no dramatic difference there either.

Our healthcare business and emerging markets business margins are a little lower than North America. I can start comfortably saying that directionally. That is really all the detail on sub-segments that we care to get into.

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

Let me come in on the field efficiency part of that question. So, Ken, you have been with us a while, you remember, I'm sure, when the Security business in North America started having some issues about a year -- a little over a year ago, that we discussed at the time one of the reasons for that was that we had made an organizational change where we had taken the structure that we had been running the CSS business on historically, which was a centralized structure, in terms of metrics management and field deployment. And we had pushed that centralized structure out into about 80 P&Ls in the various geographical regions of the United States, and had placed accountability at that level for managing P&Ls, and then rolled it up into a total in regions and in total. And it turned out that particular move was not a very smart one.

So when we started going backwards in the field, about a year or so ago, in terms of efficiency, we determined that one of the reasons was that we did not have the people running these P&Ls that were really capable of managing the efficiencies and the labor loading, and all the complexities that go with managing a field like that. So about nine months ago, we reversed that decision, and we went back to the centralized model, and now what you're seeing is the benefits of a very, very metric-based daily management, intense management model, which is the way that you make money and manage your field effectively, in electronic Security business. And having made that mistake once, we will not make it again, I can promise you. But it is nice to be back on the mend.

Operator

Our next question comes from Winnie Clark from UBS.

Winnie Clark - *UBS - Analyst*

You talked about the headwind you saw at CDIY in North America in the second quarter, as retail of the inventory replenishment came to a halt. Have you started to see that come back, and is there a potential for the tail of the outdoor season to be a bit longer or stronger due to the slower start that you saw? And then, could you see some benefit from restocking in the second half?

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

The outdoor season is so very specific to the first quarter and the second quarter, that there is very little replenishment that goes on in the third quarter, and really what you have got now is the retailers just trying to make sure that they don't get stuck holding the bag with a bunch of inventory, so there is really no chance for, I'd say, really any significant upside or downside relative to outdoor.

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

I think that's very well said. To oversimplify what Jeff Ansell's team would say -- you get to the middle of June, that season is over. They're already looking forward to fall products.

So we're optimistic what's there will sell through but due to the late start, to Jim's point, it was the reorders that didn't take place and that is one of our few seasonal businesses, in their minds the season is over. That volume probably -- there's no reason to think that volume in terms of shipments will come back. And we're moving on from there.

Operator

Our next question comes from Dennis McGill from Zelman & Associates.

Dennis McGill - *Zelman & Associates - Analyst*

Don, sorry if you mentioned this, but can you break out the second-half assumptions embedded in that 4% to 5% organic across the major regions? I guess just compared to the volume that you saw the first half growth?

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

This -- the second half region?

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

Take the 4% to 5% organic growth in the second half, and break it geographically.

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

Yes. No problem. We don't really give it that way, but the reality is, when you look at the trends that we've seen in our Company and some of the commentary that Jim has mentioned this morning, we've seen a very strong performance in certain pieces of our European business. Other pieces, such as Security Europe, have been a little weaker.

Emerging markets had a solid performance in Q1, and then had some volatility in Q2. And we expect that to improve in the back half, for all the reasons that Jim walked through around MPP.

I won't give you specific numbers by region, but what I can tell you is that from a trend perspective, that is how things will move. I think Europe will be relatively consistent, with a little bit of it tailing down, as we start to comp some difficult comps in CDIY Europe.

Emerging markets will ramp back up from what we saw in Q2, and get stronger. And then the US will be a little stronger than what we saw, because we were definitely impacted by outdoor in a negative way, and we don't expect that to repeat. So we would expect a modest improvement in that particular performance.

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

And to help you with your modeling, it's too much detail to get into on the call. We do include it in the appendix in tremendous detail, in terms of year-to-date performance in history.

But just thinking at a high level, 50% of our global business is in the US, or 53% is in North America, 25% in Europe and 25% in the rest of the world. The rest of the world is clearly going to grow faster than North America and Europe, and a weighted average gets you to the 4% to 5% in the second half, and the 3% to 4% for the year.

Operator

Our next question comes from Saliq Khan from Imperial Capital.

Saliq Khan - *Imperial Capital - Analyst*

I know Security has been talked about previously as well, but if you're looking at most of the drag from the overall revenue growth, it's previously been the result of the Security business, particularly as we're looking at Europe. Now Stanley has been criticized by the investment community for a lot of its challenges within that division, which has traditionally been a very high margin business. There have even been talks about the divestiture of the Security business from the rest of Stanley, I know someone mentioned that previously as well.

Now, we've been writing a lot about the Security turnaround strategy for several months now. It's really nice to see that Security is finally seeing an uptick. With that being said, within the vertical market penetration, specifically in North America, which segments are you seeing the most traction in and what is working within those segments that you can use to penetrate in other segments, and also try to emulate that strategy in the European market, as you look into the back half of 2014 and go into 2015? And I know that a large number of the sales force within the Security sector has previously been replaced by those people that are not just looking at the older business and working on the older business, but really farming -- not just looking for new business, but also farming from existing business as well.

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

That's quite a statement there. The question in there is in terms of which verticals are gaining traction, and I think, also very important, the plans for implementing our US vertical strategy in Europe, which you've already said once is on a much slower time frame. Those two issues, which verticals are gaining traction in the US, and is there learning that applies to other verticals? And then second, I think will help the audience the most.

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

Our order rates are running close to $100 million annualized on the verticals, and within that $100 million I think the number one vertical would be retail. And we've been doing some work in integrating EAS systems with Security systems, that seems to be very appealing to large retailers, and we've had one very large win, and then a couple of smaller ones, and we see a couple on the horizon in retail.

Which is a very unique value proposition that nobody else is providing at this point in time, which does a lot of what we will call data analytics, for the headquarters and the regions of the retailers. So that's one exciting area.

Another one is healthcare. Our healthcare activities are really divided into two pieces. One is the traditional Security business, that covers acute-care facilities and senior living facilities, and just medical facilities in general. And that is your basic Security systems, but we also have this other part of our business, which is, we call it healthcare, but it is a patient security -- it's centered in patient security. It started that way, but now it's kind of evolved to an asset tracking, a patient safety, a compliance, a productivity generating business, that really ties together a lot of software solutions with hardware components, and peripherals, and brings the ability to manage the hospital better or the senior living facility better.

And we are combining that now in a go-to-market basis in selected areas, with our core Security business. What we're finding is that the value proposition that we can bring to the C level type people in hospitals, for example, is very, very compelling. So we have -- we've had some wins already that are pretty significant there. And we have some wins on the horizon that I think will be eye-opening in size.

And then another one is higher education. We've had several significant universities, wins in the last six months or so. And these tend to vary from providing campus control solutions, to more traditional, or more basic Security solutions. But we have a lot of -- several technologies today that we're weaving together as we go to these various verticals.

And one of them is the RTLS technology that we gained through the AeroScout acquisition. And another one is the EyeLock technology, that we have exclusive rights to, in these markets.

And then we have done a really nice job, I think, also integrating with the PSIM systems, the basic security systems, so that we can go to a customer and take what might be a hodgepodge of various security systems that they might have installed across their enterprise, and tie them together in a better way. So these are all at the root of the success of the vertical initiative, and I think just to focus on becoming a subject matter expert in each one of these verticals, and providing the solutions to the customer.

The ability to transfer this to Europe, I think, we are getting very close to the point where we can begin to do that. That will not be an overnight sensation, and it will take at least one to two years for it to really settle in and start driving the growth there, I think.

But it is very powerful, these solutions are transferable. There's not a lot of whole lot of extra work that needs to be done to take them to Europe, in terms of the product modifications. It's really more about preparing the European sales force to sell these and commercialize these.

And that is something that we want to do, but we also want to make sure that the environment is stable, and that the talent is there to be able to do that, in Europe. And we are nearing the time when we can make that happen. But it's going to be a few more -- a quarter or two before we actually make that happen.

Operator

Our next question comes from Liam Burke from Janney Capital.

Liam Burke - *Janney Montgomery Scott - Analyst*

IAR had a good quarter with Mac Tools up so the automotive vertical looked pretty strong for the quarter. Are there any other verticals that contributed or have shown unusual strength either in this quarter, or as you see it going forward?

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

Broad-based. Liam, I don't know if you jumped on the call late. I talked a little bit to a previous question on the Industrial segment.

As you know, IAR and engineered fastening are the big businesses, and engineered fastening is about 50% OEM auto, the other 50% spread across aerospace, consumer electronics and other verticals. The rest of that segment, as you know well, is Infrastructure, our Hydraulics, and our Oil and Gas businesses. All performed extremely well in the quarter.

So we really have broad-based organic growth and operating leverage across the entire Industrial platform. It was a very encouraging quarter, and no one specific vertical or end market to single out as being an extraordinary driver.

Operator

Our next question comes from Sam Darkatsh from Raymond James.

Sam Darkatsh - *Raymond James & Associates - Analyst*

Terrific quarter, and obviously, in parts of the world that are very challenging right now. Very encouraging to see.

My question -- the inventories on a year-on-year basis were up pretty sharply. I don't think I should be too worried about it. You did mention, Don, that you are expecting working capital to improve by year-end, and you did raise guidance, but where are those inventories on a year-on-year basis, and was there any benefit to fixed cost absorption during the quarter?

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

Thanks, Sam. As I mentioned back in the April call, I actually indicated that we would be most likely building some inventory in the CDIY business in the second quarter, to prepare for the remainder of the year, to prepare for the MPP rollout in emerging markets. And as I indicated a few minutes ago, the working capital turns pretty much came in line with our expectations by the end of the quarter.

You're exactly right. The inventory levels are a little bit higher than maybe what we were originally anticipating six months ago or so, but they are right in line with what we are anticipating as we began the second quarter.

We feel good about how we are positioned for the remainder of the year. We have very robust plans, like we do every year, in place to address the inventory payables and receivable level over the next six months. And feel that the working capital numbers that I provided are very achievable.

As far as absorption, yes, we obviously get an impact, that was part of our guidance, part of what we planned. It was not very significant, but clearly it does have an impact when you have a higher level of inventory versus the prior period, the prior quarter. But didn't arrive anything significant beyond our expectations, it was right in line with where we expect it.

Operator

Our next question comes from David MacGregor from Longbow Research.

David MacGregor - *Longbow Research - Analyst*

Just on European Security, congratulations on getting your attrition rate down to 10 to 12. I know that's required a lot of work and effort. I guess the question from here is the other side of the equation, is how do we grow the business, and what might be achievable in terms of growing the RMR portfolio from here? And if you could talk about what the most impactful levers are to you at this point? Thank you.

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

Sure. You're right on. The first order of business was to keep what we have and then in the process, while we were doing that, we were also -- and have been for almost two years, building a sales force and a commercial engine for that business, because when we acquired it, we didn't have one. We had an organization that was reliant on its cousin, which was the Securitas Corporation.

I would say that sales force rebuilding process has gone reasonably well, in most geographies, and if we set aside Spain and Italy, which really, if you look at the organic growth being down 6% in the second quarter, it was down 7% in the first quarter, what you have there is two things going on. One is the spillover effect of the prior attrition from prior quarters having an impact, but equally as important, the installation business is down, and it derives from Spain and Italy being about a third of the issue. And then beyond that, you have -- we have a very, very focused initiative to make sure that we are not taking on business that is low-margin business, and low value-added business, so that has an impact.

And then finally, it's just a matter of making sure that we have the requisite number of salespeople or feet on the street on the payroll. And I'd say we're doing -- we need to deal with the Spain and Italy, issue, as was talked about earlier, so that's part of it.

And then I think the feet on the street issue, where earlier in the year, we were down probably about 30 to 40 people versus what we needed to have or wanted to have, in sales in Europe. And I think today we're right around 10 -- down 10. We're making a lot of progress on that front, getting to where we need to be.

And the order rates in the back half of the year need to come up. They are negative right now, consistent with the organic growth numbers, and they need to come up.

So that is the focus right now, is to make sure that the feet on the street are performing, and all this is very tactical. But as you've seen when we address these tactical issues in sequence here, we've been relatively successful, so we're confident that we can get that done.

And then of course the longer, medium to longer-term solution to this, is to have these vertical market products and the vertical markets sales organization that was discussed a few minutes ago, transferred over to Europe. So this is a staged execution project, just like everything else we've been doing here. And right now we're at the stage of making sure that the origination capability of the organization is not only there, but performing at a level that is acceptable, and then of course, the next step from there will be bringing in the vertical market solutions.

Operator

I will now turn the call over to Greg Waybright for closing comments.

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

Paulette, thank you. We'd like to thank everyone again for calling in this morning, and for your participation. 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.
