Stanley Black & Decker Inc at Barclays Industrial Select Conference

NEW BRITAIN Feb 16, 2021 (Thomson StreetEvents) -- Edited Transcript of Stanley Black & Decker Inc presentation Tuesday, February 16, 2021 at 5:10:00pm GMT

CORPORATE PARTICIPANTS
Donald Allan, Stanley Black & Decker, Inc. - Executive VP & CFO
Lee B. McChesney, Stanley Black & Decker, Inc. - Chief Finance Officer of Global Tools & Storage
CONFERENCE CALL PARTICIPANTS
Julian C.H. Mitchell, Barclays Bank PLC, Research Division - Research Analyst

PRESENTATION

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

Great. Well, I think we're live now so thanks, everyone, for joining. It's my pleasure to have now Stanley Black & Decker, Don Allan, CFO; also Lee McChesney, CFO of Global Tools & Storage.

I think I'll hand over, first of all, to Don for a couple of prepared remarks. As a reminder, anyone dialed in, please e-mail me your questions to ask. And also, if you get a second, please note the survey questions at the side of the screen. So with that, I think I'll hand over to Dennis and court and also, of course, Don and Lee.

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

Okay. So thank you, Julian, and good afternoon, everybody, and -- or good evening, depending on where you are on the globe.

So I'd like to maybe spend 5, 10 minutes going through 3 pages around Stanley Black & Decker. The first is a bit of an overview of our company. And you can see that our revenue for last year was about $14.5 billion, market cap in the high $20 billion, $28.1 billion. And then 3 different significant businesses, the largest is our Tools & Storage business, which is just over $10 billion, made up of power tools, hand tools, accessories, storage and certainly some outdoor business in there as well, outdoor products.

And then industrial. A little more than $2 billion in revenue, heavily weighted towards Stanley Engineered Fastening and our Infrastructure attachment tool business. And then last, but certainly not least, our security business, just under $2 billion, with a heavy weighting to our commercial electronic security business in that part of the portfolio.

As we've said before, we want to be a company that's known for innovation. We think we've had a great track record of innovation. We want to continue to invest in innovation in all of our businesses and build upon that track record, continue the top quartile performance as well from a TSR perspective and financial metrics. And then also be a company that is socially responsible and really doing its part in the world and trying to be a force for good globally.

So with that, if we could flip to the next page, a little bit about our value creation model and just a refresher for everybody. We believe that we have really built some -- a company that's full of world class brands.] Very attractive growth platforms that are scalable and defensible franchises. And as I mentioned earlier, we've really differentiated ourselves through innovation and continuing to bring innovative products to our customers and our end users, which means our businesses are strong, driven by innovation and diverse and in global markets.

And we use our operating model at Stanley Black & Decker to focus on innovation, operations, margin resiliency, extraordinary customer experience and in the center of our operating model is people and technology or talent and technology. And when we apply those principles to our businesses and all those different processes and talent, we really think it allows us to achieve our long-term financial objectives that you see over there on the right, the 4% to 6% organic growth, 10% to 12% EPS growth and then [ROI] between 12% and 15% over the long term.

And up above that, you can see, if you look at the 10-year time horizon, really solid performance of 10% EPS CAGR, 9% in the last 5 years and 7% EPS CAGR in the last 3 years. And if you look at that 3- to 5-year time horizon, we dealt with about $1 billion of headwinds in 2017, 2018 and 2019, that really had a significant impact, but yet, we still were able to grow our earnings at a fairly significant rate and very close to our long-term financial objective of 10% to 12%.

And when we achieve that type of performance, we get strong free cash flow. And you can see that free cash flow CAGR in that table, which allows us to have a very investor-friendly capital allocation strategy of taking about half of that over the long term and returning it and investing it in our M&A within our franchises and then returning the rest of it to our shareholders through the dividend as well as the occasional opportunistic share repurchase. And so these world-class branded franchises really allow us to have a sustainable set of strategic characteristics that ultimately has demonstrated on how it creates exceptional shareholder value.

And so the last page I'll touch on is a reminder to everybody is that we really believe that we have developed a strong growth track record at Stanley Black & Decker. But the journey is far from over. There's a lot of opportunities in front of us. And there's 3 big areas that we've highlighted here in e-commerce and the investments we're making, primarily right now in our Tools business. And that's not just a North American opportunity but a global opportunity.

Reconnecting with the home and garden. This real opportunity has emerged out of the pandemic as a big positive that -- and if you could look at -- you could look at it as a short-term opportunity but we're looking at it more as a longer-term opportunity that goes beyond the pandemic as people begin to spend more time at their homes, it becomes a center of a lot of their activities and potentially a center for where they actually work on a part-time basis, as most companies will migrate to a hybrid type structure environment.

And then health and safety and using our security business as a way to kind of reimagine the business and the opportunities that we've built in our innovation ecosystem over the last 3 to 4 years are actually a perfect fit for commercial health and safety solutions as people begin to migrate back to the workplace and also can help existing workplaces that have been fully operational through the pandemic such as manufacturing locations and retail operations, et cetera. So we're positioned for continued share gain and margin expansion. And we think that is the opportunity ahead to continue to grow and drive shareholder value. So thank you, and I'll pass it over to you, Julian.

QUESTIONS AND ANSWERS

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

Question – Julian C.H. Mitchell: Thanks very much, Don, for that introduction. I suppose one question, perhaps, just starting off with the top line environment. It's been shifting radically sort of quarter to quarter for 10 months now. Just wondered if you could provide any update on sort of near-term trends and particularly that sort of bifurcation where industrial and security have been lagging, Tools & Storage extremely strong, if that sort of wide gap is persisting through this year as well so far.

Answer – Donald Allan: Yes. As we go through this year, and we talked about this 3 weeks ago in our earnings call, that we really expect strong organic growth in Tools & Storage especially in the first half. And we talked about 30% to 40% organic growth in Q1, and we continue to see that. We're very pleased with the POS performance so far through the stage of February, and it really does support that type of trend and performance.

The Industrial business continues to improve. And like we were expecting, we expected potential for a little bit of growth here in Q1, but we also said it could be down a little bit year-over-year in our guidance. So we'll see how that plays out but it's trending in line with expectations.

And then Security, same thing. We expect a little bit of growth, hopefully, in Q1 and at this stage, we feel like it's trending along those lines. So the good news is that we started the year out in line with expectations and we'll continue to watch this. This is a changing -- as you said, it's very volatile. And we'll see how the next 6, 7 weeks play out for the remainder of the quarter and whether we exceed expectations or whether we stay in line with those expectations. But the early read is very positive for the year.

And then as we think about the rest of the year, I think Q2, we'll see continued improvement in Industrial and Security and higher levels of growth versus Q1. And Tools & Storage will have a very strong organic growth story as well in Q2. The big opportunity, I think, for Tools & Storage in Q2 is really rebuilding those 4 weeks of inventory that we talked about in our customers. And it seems like we're not going to have an opportunity to make much progress on that in Q1 just because the POS and the demand is so high.

But at this stage, we think there could be a possibility that we make a lot of progress on that in Q2. If we don't, if demand continues to be strong, then that creates a nice back half opportunity that could really help mitigate some of the pressure we might see when that back half come. And then the rest of the company, Security and Industrial will continue to show growth through the remainder of the year.

So the profiling is really interesting. And I think when people focus on Tools & Storage and think about the back half, we put out something there out something externally that we think is balanced and reasonable, and it represents about 4% to 10% growth versus 2019 back half. But we also said 2.5 weeks ago that there could be an opportunity that these markets stay strong. And so we have prepared our supply chain and our operation manufacturing footprint to meet a stronger market if it's there.

And because we don't know exactly how this is going to play out. The virus may be around longer than we want it to be. We may be home much longer than we want to be. And so if that's the case, a lot of these trends could be really robust for a longer period of time. And we want to make sure we, as a company, are prepared for that.

Question – Julian C.H. Mitchell: Understood. Thank you, Don. And I suppose on the Tools & Storage side, as you said, that back half guidance is very, very explicit. Sounds like it's triangulated off that sort of 2-year-ago base and grow from that. So maybe any more color around that. And also the professional versus sort of DIY aspects of the market. What are you assuming for those 2 within the construct of that sort of second half outlook at Tools & Storage?

Answer – Donald Allan: Yes. I think right now, based on the outlook we've provided, I would say that in the back half, we're expecting the DIY tend to be good but not be as strong as it has been. But the pro performance continues to get better and better and stronger. And we saw that really turn a bit in the third quarter but then it really turned to the positive in the fourth quarter of last year. We're seeing positive trends again here in the first quarter. And we think that, that pro trend is going to continue as -- the activity around construction and new home purchases is really significant across not only in the United States but a lot of countries. And so that's really creating a lot of activity for the pro and the tradesmen, for that matter, depending on whether it's a renovation or remodel.

And so I think that trend is going to continue. I really think we're going to see -- as these economies recover, you're going to see a strong professional recovery continue. And then right now, we're saying that DIY might kind of moderate a little bit in the back half. But like I said earlier, we don't really know for sure if that's how it's going to play out. We're planning for an opportunity that could be better. And if it isn't, we'll adjust. But it really does depend on how well -- how much we get this virus under control by the middle of the year.

Question – Julian C.H. Mitchell: Yes. And within Tools & Storage, I think e-commerce as a channel for Stanley has sort of really come into its own over the past 12 months. Maybe any sort of context around where we stand today on that channel in terms of growth and share of the overall business in Tools & Storage? And how much can you use it as a lever to build the market share of Stanley maybe in geographies where the brand or market share historically has been a bit lower?

Answer – Donald Allan: Yes. It's a great question. I'm going to pass it to Lee, but we're really excited about the e-commerce opportunity. And we love the progress we've made in the last 10 years and got a bit of a jump-start last year because of everybody being at home. But we look forward, we see a wonderful opportunity not only in North America but in market -- like you said, in markets where we don't have big share today. But Lee, why don't you give a little more color on that?

Answer – Lee B. McChesney: Yes, perfect. So Julian, as Don said, we're delighted with the e-commerce results from 2020. And I think they have their foundation in really a 10-year run up to where we started the year. So we saw an excess of 40% growth in e-commerce in 2020, just coming shy of $1.9 million. Depending on the month of the quarter, it was almost 20% of our sales.

And that's still the same mindset we have as we go into '21 here or '22. And that number actually could creep up as we make additional investments in e-commerce. And as you said earlier, I mean, it's working with the partners we have today. It's a top topic for them as well so we can bring something to table to help them accelerate. It resonates well. And then to your point, there's parts of the world where maybe Stanley Black & Decker doesn't have as strong a share. There's opportunities to partner with some new channels, and in some cases, even go direct. And that's all part of this journey.

What's nice is no matter what part you step in, they really help complement each other here. So if we make an investment into content to even do more in multiple languages, it works with all channels, whether direct or whether through a partner or things like that. So one thing we did do last year as the POS recovered versus the early days of COVID is we've made an additional investment in e-commerce.

And I mean, the reality is content is important, the technology you have, just how smart you are with e-commerce. Because the question you didn't ask would also be the profitability that comes in e-commerce. And we have a nice momentum there, where it's really very much in line overall, in some cases, actually positive. I'd say in areas where maybe we're making newer entrants in e-commerce, maybe it's a little bit lower to start off with.

But those investments go everywhere. I mentioned some of those areas, but there's just different platforms, whether it's the websites, whether it's investments you make to help your partners be successful. And I would tell you that, that momentum's continued so far here in '21. And as we think about also the back half of the year, I mean, this is a space we think will actually still continue to grow. So it's another opportunity to distinguish and, frankly, deliver some maybe -- even a little bit more growth than we can currently walk in for the back half of '21 here. So very optimistic in e-commerce, a big part of our story going forward here.

Question – Julian C.H. Mitchell: Understood. And maybe switching to margins. I think, Stanley, a big focus whenever you get bouts of inflation is what happens with that input cost base and the ability to offset that. So perhaps frame for us in the context of the guidance for this year, what the comfort level today is in that input cost headwind that's been guided. And also how quickly, if that headwind grows, how quickly can the margin resiliency sort of offsets be put to work?

Answer – Donald Allan: Sure. So yes, we talked about $75 million of inflation for 2021 is embedded in our guidance. And it hasn't really changed much. That number is what it still is kind of trending at, at this point. There's been some ups and downs and different trends but it's still hovering around that number.

We look at it and say, okay, how do we manage through this period of time? Because the long-term solution for this is if this is sustainable inflation, you've got to sit down and negotiate with your customers and talk about where are the right places to do price increases and which product families are impacted. The short-term solution, though, is what you said, which is let's pursue surgical price increases but let's really execute on our margin resiliency initiatives where we have $100 million to $150 million of initiatives that we believe will create value this year that are not -- is not in our guidance, and it's really there to help offset any new things that come our way.

Obviously, this is an area that could be the case if inflation got bigger. We have enough coverage to $100 million, $150 million. And those things are being executed on today. So it's not like we're waiting to -- until a new wave of inflation comes. We're actually doing them today. And so the value is going to come no matter what. And so if we don't have a new headwind that comes our way, it actually creates an opportunity for us to outperform on the profitability side versus the current outlook or guidance.

So we think it's a nice way to manage through these cycles where we see headwinds, whether it's currency or whether it's commodity inflation. It helps us navigate through the short-term input cost increase. And then the longer-term reaction is to really get an offset in price. And if you look at our longer-term trend related to currency and commodity inflation, we historically have gotten about 80%, 90% of that recovered over a multiyear period of time.

Question – Julian C.H. Mitchell: And tying it up, I suppose, to the overall Tools & Storage margin outlook beyond just this year. This year, you should be 19%-plus, I think, margin in Tools & Storage, higher than prior historical peaks. Beyond this year, what sort of operating leverage do you think Tools & Storage can continue to drive in a normal sort of cost environment? We always get questions around the power of the channel, the aggression on price of competitors at certain times. So factoring in those types of elements, what kind of incremental margin do you think is sustainable? How high could those Tools margins move?

Answer – Donald Allan: Yes. I think the Tools margin opportunity is still fairly significant. And because if you really -- if you dissect the business, the operating margins in the back half of last year were obviously over 20%, which is fantastic. But the gross margins are still far below historical high levels. So the opportunity is really there. How do we price better? How do we really leverage the supply chain and the Industry 4.0 opportunity to improve our gross margins?

And so when I look at that, I say, okay, well, I still have a business that you could have 200 to 300 basis points of gross margin opportunity in front of them. And then maybe you do a little more of new investments in SG&A as the business grows. But I feel pretty good about the possibility of the business being able to get to 20% profitability on a consistent basis and maybe even modestly exceed it over the long term for the reasons I just articulated.

There's no reason that this can't be a 40% gross margin business. And if that's the case, then you're looking at a business that the SG&A is already running sub-20%. And so if you just stayed at 20% and you're running a little bit below that, you're going to be in that kind of that ballpark from a margin perspective.

Question – Julian C.H. Mitchell: Very clear. Maybe switching to the portfolio side of things. There's been discussion in the past around the status of Security within the portfolio, also within the Industrial division, potential portfolio changes at that. Understand things were put sort of on ice in some respects because of COVID. But how in your view -- how satisfied are you with the performance of Industrial and Security during the downturn? And is there anything from that, that we should read for their place or parts of their place in the portfolio?

Answer – Donald Allan: I think we're very pleased with how they performed or how they responded to the top line pressure they experienced, especially in Q2 and Q3 to position themselves for a really successful strong operating leverage in 2021 as they start to demonstrate growth. And I look at Industrial, in particular, and say, okay, I think they've done a really good job positioning themselves as these markets start to bounce back.

The challenge they're going to have is it'll be somewhat constrained in 2021 just because there will be a few pieces of the Industrial portfolio, aerospace, fasteners and oil and gas, in particular, that are going to continue to retract for a period of time here in 2021, while other parts of the business are growing. So overall, we'll still see growth but we won't see 10%, 15% growth across the entire segment. And so that will put a little bit of limiting governance on how much it bounces back.

But I feel really good about that. And we'll have to continue to look at that portfolio overall. There might be a few small things we want to prune in there that we have to look at over time. But I think overall, it's still a really solid business. And as the global economies recover, I think we're going to see that bounce back.

On the Security side, a similar story, although they didn't see the same magnitude of a revenue decline as Industrial did or even Tools did in Q2. So -- but they did position themselves well to be able to demonstrate solid growth this year and continued profitability improvement. And so as the year ends in 2021, I think we'll look back in Security and say, okay, this is the year that they demonstrated organic growth for the entirety of the year, and they continue their journey of improving their profitability.

The thing that's exciting about Security is that the new growth initiatives around health and safety are higher levels of profitability. So it's going to help them get to a similar story around gross margin. How do they get to 40% gross margin versus 36%, 37%, 38%? These are the types of things as we continue to mix into higher-value proposition solutions for our customers, better pricing, better profitability and leverage the SG&A base we already have in the business to eventually get them to be a 15% OM business.

So I feel like we're positioned well. I mean, this is something we have to watch very closely, in particular, Security and just do they progress the way we want to. They're very much on our radar. And we're -- right now, we like them being part of our portfolio because we see it as a value creation opportunity going forward. But we will monitor and watch that very closely.

Question – Julian C.H. Mitchell: And then Don, sort of free cash flow, it's swung around a bit with working capital headwinds and then tailwinds obviously during COVID. Probably some moderation on that free cash flow margin this year because of working capital. But when you think about conversion, any reason you shouldn't be at that 100%-plus in the medium term? And to your point, if we see that Tools margin operating-wise expand, does the Tools and the firm-wide free cash margin kind of move up alongside it?

Answer – Donald Allan: Yes. I think the free cash flow conversion should be, in the short term, around 100%. Midterm, I think there's -- medium term, I think it's a possibility to be above 100%. And so yes, clearly, we had an amazing free cash flow conversion in 2020 at almost 140%. And we will see a little bit of working capital pressure here in 2021. And we do need to get our CapEx levels up a little bit versus what they were. And we really cut back in 2020 to ensure that we're being very financially prudent.

But there's some things we need to do with our supply chain moves and operations that we have to invest in CapEx in and we're going to have to ramp that up in '21 and '22. So that will mitigate a little bit. We're still going to be looking at a pretty robust absolute free cash flow number for 2021. It probably will be somewhere around $1.3 billion, $1.4 billion, maybe a little bit higher. So it will still be a really positive story that allow us to continue to invest in our businesses and also look at other capital allocation opportunities as they emerge.

Question – Julian C.H. Mitchell: I think one of the main potential uses of the cash will be that increase in the MTD stake. Maybe give some more color around kind of medium-term top line growth expectations for that business and the broader lawn and outdoor market. And also, how major are the levers that Stanley can pull to get that mid-single-digit margin substantially higher at MTD?

Answer – Donald Allan: Yes, I mean, we think the outdoor business with MTD eventually require the remaining 80%, can be a business that is in our long-term financial objectives for organic growth of 4% to 6%. We also think it's a business that could be, at least initially, 15% operating margin rate. And the reason we feel that way is, as the 2 companies come together, using all the different brands that we have and they have to leverage some really amazing opportunities in retail but also leverage opportunities in the pro dealer independent network, where the bigger solutions are higher levels of functionality, which is also where the higher levels of profitability is in the business.

And a brand like DEWALT would resonate very well in that channel, and you combine that with the service and parts business that MTD has to service those customers under that brand on an ongoing basis. We think that's just a fantastic opportunity we can leverage. But then there's the other things that we'll do to improve the profitability, which will be accelerating procurement savings, consolidating back office functions into our existing business functions, looking at the operations, manufacturing and supply chain footprints, any other things that we can do with our outdoor business and their outdoor business, maybe even some of our Tools plants where we can really flex the volume and really minimize the seasonality that sometimes plagues this business, especially in the first quarter of their year or the fourth quarter of our year.

So we're excited that we think that they can get it to close to 10% profitability by the end of this year. We think we can do things that get to 12%, 13% initially. And then we really hit the pro dealer hard, that network hard, that's the caper that gets it to 15% or better.

Question – Julian C.H. Mitchell: That makes sense. And I suppose with that, where your leverage, where it is today, with that stake increase potentially coming, should we assume the next sort of couple of years, capital deployment beyond that is fairly limited?

Answer – Donald Allan: Well, I think there's always things that pop out and I think we have to be able to respond to that. But right now, we're probably -- we have Industrial on a path to recovery. We have Security on a continued transformation journey. Probably not a lot of M&A activity in there in the next couple of years. Outdoor, we have MTD. Could there be a small other outdoor thing that comes along? Possibly. Maybe that would be a good fit to that model.

And then there's always a possibility that some tool assets come up that we would have to seriously look at and really build upon our powerful Tools franchise. But I would say that's probably the focus between Tools and outdoor is where you'll see the bulk of the M&A activity in the next 2 or 3 years.

Question – Julian C.H. Mitchell: Fantastic. And maybe one last one. I know we're almost out of time, but just an e-mail from someone around that notion on the Tools & Storage side just in the very short term. The inventory levels, I suppose, how would you characterize those versus normal seasonality for this time of year? Are you seeing selective restock already in certain pockets or certain channels? Or is all of that really still on the come sort of down the road this year?

Answer – Donald Allan: Yes. It's still further down the road. We're seeing, what I would say is historically low levels of inventory in the stores, not so low that we're having major stock-out issues and challenges like that. But just when each customer has kind of their range of where they want their inventory to be based on number of weeks on hand. And in both cases, we're at the low end of those ranges. So that 4-week opportunity is really, in the second quarter, how you build that up or maybe third quarter, build that up to that, either the midpoint of that range or the higher point of the range, depending on the customer's desire or requirements.

Question – Julian C.H. Mitchell: Perfect. Great. Well, I think we're out of time, unfortunately. Thank you so much, Don and also Lee, for taking part in this fireside chat and wish you all the best of the remaining investor meetings.

Answer – Donald Allan: Great. Thank you, Julian. Thanks, everybody.

Question – Julian C.H. Mitchell: Right.
