Q3 2020 Stanley Black & Decker Inc Earnings Call

NEW BRITAIN Oct 27, 2020 (Thomson StreetEvents) -- Edited Transcript of Stanley Black & Decker Inc earnings conference call or presentation Tuesday, October 27, 2020 at 12:00:00pm GMT

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

Jeffrey Todd Sprague, Vertical Research Partners, LLC - Founder & Managing Partner

Joseph Alfred Ritchie, Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst

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

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

Michael Jason Rehaut, JPMorgan Chase & Co, Research Division - Senior Analyst

PRESENTATION

Operator

Welcome to the Third Quarter 2020 Stanley Black & Decker Earnings Conference Call. My name is Shannon, 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 Relations, Dennis Lange. Mr. Lange, you may begin.

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

Thank you, Shannon. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's 2020 Third Quarter Conference Call. On the call, in addition to myself, is Jim Loree, President and CEO; and Don Allan, Executive Vice President and CFO.

Our earnings release, which was issued earlier this morning, and a supplemental presentation, which we'll refer to during the call, are available on the IR section of our website.

A replay of this morning's call will also be available beginning at 11 a.m. today. The replay number and the access code are in our press release.

This morning, Jim and Don will review our 2020 third quarter results and various other matters followed by a Q&A session. Consistent with prior calls, we're 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 based on our current views. Such statements are based on assumptions of future events that may not prove to be accurate, and as such, they involve risk and uncertainty. It's therefore possible that the actual results may materially differ from any forward-looking statements that we may make today. We direct you to the cautionary statements in the 8-K that we filed with our press release and our most recent '34 Act filing.

I'll now turn the call over to our President and CEO, Jim Loree.

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

Thank you, Dennis. Good morning, everyone.

What an eventful year it has been thus far. Going into 2020, we expected some volatility and uncertainty. However, no one could have anticipated the ups and downs and the twists and turns this year would take, and there are still 2 months to go.

As you saw from this morning's press release, our team is doing an impressive job managing through the trials and tribulations of this era, and I want to thank every one of our 54,000-plus associates who contributed to those results.

I'm happy to say that we nailed what was perhaps one of the best quarters in our history. Pick your metric: gross margin, operating margin, free cash flow, the list goes on. For me, the most gratifying is the operating margin rate of 17.7%. We've proven over the decades since the Black & Decker merger that we can produce organic growth at a reasonably consistent 4% to 6%. However, our goal has always been to marry that up with relatively consistent operating margin rate accretion, with the goal of breaking through that 15% ceiling at some point. That has been elusive until now.

In late 2017, we entered what turned out to be a 3-year period of significant external headwinds caused by tariffs, cost inflation and FX pressures, all totaling approximately $1 billion of unfavorable margin impact. With a lot of work and a strong constitution, we were able to offset those headwinds and generate a 6% EPS CAGR during that era.

We also bought IRWIN, LENOX and Craftsman, among others, and utilized those acquisitions to cement incredibly strong strategic partnerships with our 2 major home center partners in the U.S. as well as building a thriving e-commerce business, including a partnership with North America's largest e-commerce player.

And when the pandemic hit by April, we faced into 4 weeks of revenues down 40% as the world went into lockdown and most retail channel partners dramatically cut their ordering. In response, we beefed up our already strong liquidity position and took out $1 billion of cost, including $500 million of indirect or nonpeople-related costs. We managed to keep our supply chain running with only minor disruption, including operating over 100 plants around the globe, and have done so successfully throughout the pandemic.

Then a strange thing happened in North America. People stuck in their homes began to do projects, some DIY, some through tradespeople and contractors. And POS and our retail partners began to skyrocket in May and has been at unprecedented levels ever since. By May, retailer inventories were plummeting. And recognizing that our supply chain lead times would preclude us from serving the demand if it's sustained, we took a decision to invest $600 million in fast-moving inventory in advance of orders from retailers beginning in the May time frame. That turned out to be an excellent call.

In the third quarter, construction and DIY tool revenues in Europe and the emerging markets began to recover while North American retail stayed strong. This caused positive revisions to our revenue estimates and ultimately drove double-digit growth in Tools in the third quarter, even while some of our revenue shifted into October in the final days of September.

So with that as backdrop, why am I so excited about our record 17.7% operating margin rate? The reason is that we believe we've achieved a new range of profitability to couple with our continued organic growth. Yes, continued organic growth.

We believe if 2021 is a reasonably stable economic year, that the 40% of our portfolio that in 2020 will be significantly down organically, that is Industrial and the Security segments, as well as industrial tools will bounce back and become a positive.

We also believe that Tools and outdoor will be very strong in 2021 with channel inventory rebuilds and continued pandemic end demand at least into the first half. Our e-commerce position, which will approach $2 billion in 2020, should also continue to be a robust growth driver as we capitalize on our strength and make continued investments to make it even stronger.

We also believe that approximately $625 million of our $1 billion cost takeout will stick, resulting in some carryover benefits next year and that the margin resiliency initiative will continue to bear fruit in 2021, yielding $100 million to $150 million of additional margin tailwind.

Perhaps most refreshing of all is the absence of sizable new headwinds in the area of FX, inflation and tariffs.

For all those reasons, as we sit here today amidst all the market uncertainty, we believe the growth and margin story is sustainable in the stop-start kind of pandemic economy that we're in. My comments do not contemplate a severely pressured 2021 global economy, and we do not believe that scenario to be the likely case.

Our people had worked tirelessly to produce these results. Our third quarter financial performance reflects the agility, courage and common sense of our leaders and their teams under the circumstances, and we thank them for that.

Now for a few financial highlights. Total company third quarter revenues were $3.9 billion, up 6% versus prior year. This included 4% organic growth

and a 2-point contribution from the CAM acquisition.

And turning to profitability, we executed to deliver a gross margin rate of 35.9% or 160 basis points above that of prior year. And as mentioned, our operating margin rate was a record 17.7%, up 320 basis points. This achievement was a result of strong cost control, our margin resiliency initiative, volume leverage and price. And leading this performance was Tools & Storage, delivering 11% organic growth and a record 21.5% operating margin rate.

Industrial achieved sequential improvement in both revenue and margins despite a steep year-over-year market-driven organic decline, and effective cost management to protect margins helped position the business for outstanding volume leverage during an eventual market recovery.

And lastly, Security delivered stable results even in this climate with just a modest decline in organic growth and relatively flat operating margin.

We continue to transform this business and are investing to capture the emerging health and safety opportunity related to the pandemic. We're excited to realize the benefits from this multiyear transformation with a potential for organic growth with margin expansion in 2021 and beyond.

And finally, all of this was punctuated by record adjusted EPS of $2.89, which was up 36% versus last year, as well as $615 million of free cash flow in the quarter, bringing our year-to-date free cash flow to $391 million, up over $400 million year-over-year.

And as we look ahead, our well-established pandemic priorities remain consistent: first, ensuring the health and safety of our employees and our supply chain partners; second, maintaining business continuity and financial strength and stability; third, serving our customers as they provide essential products and services to the world; and fourth, doing our part to mitigate the impact of the virus across the globe.

The pandemic is not over yet. We are maintaining our focus and not letting our guard down as we enter the next phase and continue to manage with agility and resiliency. These priorities have helped us keep our employees as safe and secure as possible, operate continuously to serve our customers and to support our communities during this challenging period.

We will continue to exercise discipline on expenses and reap the benefits of the cost savings program put in place earlier this year. We are concurrently making investments in key growth areas associated with reconnecting with the home and outdoors, e-commerce and health and safety, even as we work to ensure that our operating margins stay in the 15%-plus Zip Code.

In summary, it was a truly notable quarter, and there's a lot to be excited about for the future, including MTD, which brings between $2 billion and $3 billion of revenue and becomes executable beginning in July 2021.

Thank you, and I'll now turn it over to Don Allan to provide you more color on the third quarter as well as our scenario planning as we look to the fourth quarter and beyond.

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

Thank you, Jim, and good morning, everyone. I will now take a deeper dive into our business segment results for the third quarter.

Tools & Storage delivered excellent revenue growth with volume up 10% and price contributing 1 point. The segment organic growth for the third quarter was impacted by the timing of promotional volume that ended up shipping in October versus our previous expectation of September. This represented approximately $100 million to $125 million, or a 5 to -- a 4- to 5-point impact versus the 3Q revenue planning assumption we communicated in late August.

As many of you know, there is a significant amount of volume that goes into the channel for the fourth quarter holiday promotions during the September through October time frame. You will see this timing shift included in the Q4 planning assumptions that I will review later.

The third quarter operating margin rate was outstanding and clearly a record performance at 21.5% for Tools & storage, up 490 basis points versus the prior year as volume, productivity, cost control and price delivered a strong margin rate expansion. As volume growth accelerated, we experienced excellent operating leverage due to the significant adjustments to our cost base over the last 6 months in response to the pandemic.

Now let's take a look at some of the geographies within Tools & Storage. North America was up 11% organically. U.S. retail delivered 16% organic growth driven by strong DIY and improving professional demand, along with continued momentum within the e-commerce platforms. POS remained very robust throughout the quarter as we experienced an average growth in the low 20s percentile over the entire third quarter. The U.S. retail store inventory levels, although up slightly from beginning of the quarter, remained significantly lower than last year.

The North American commercial and industrial tool channels continue to see a slower path of recovery compared to the strong results in U.S. retail as the commercial channel declined 7% during the quarter.

Within this channel, there are a mix of customers that serve both construction and industrial markets. If you look at pure-play, construction-focused customers in this channel, green shoots emerged, and they delivered low single-digit organic growth for the quarter, a positive signal that the pro is returning.

Finally in North America, our Industrial and automotive tools business declined 11%, which was a significant improvement from the 2Q decline of 25%.

Moving to Europe, Europe delivered 12% organic growth, benefiting from similar trends as North America as well as channel inventory recoveries as these markets emerge from the Q2 shutdowns. We believe the channel inventory increases represented approximately 1/3 of the growth within this region. The result was led by construction markets and was experienced across all major geographies, with the U.K., Central Europe and Iberia up double digits and France, Germany, Italy and the Nordics up mid to high single digits.

Organic growth in emerging markets was up 11%, led by pricing, improved demand and an inventory recovery. Latin America led the way and was up 12% in the quarter. The growth was broad-based with Brazil, Argentina, Chile and Colombia up double digits, with Mexico and Peru up mid-single digits. Asia was down low single digits in the quarter with modest growth in South Korea, India, Japan, Malaysia and Vietnam, which was offset by declines in China and Southeast Asia. And then finally, Russia and Turkey had a very strong growth -- had very strong growth during Q3, contributing to the recovery for overall emerging markets.

Now let's shift to the SBUs within Tools & Storage. Power Tools & Equipment delivered 22% organic growth, benefiting from strong commercial execution and new product introductions. Despite the difficult comps earlier in the year, Craftsman is benefiting from the strong DIY and e-commerce momentum, resulting in growth significantly ahead of our expectations and starting to approach our annual goal of $1 billion in revenue. Additionally, DeWALT is capturing the positive trajectory in the pro recovery as well as new product introductions, such as POWERDETECT, and continued expansion of our FLEXVOLT, ATOMIC and XTREME breakthrough innovations into new product in storage, which declined 5% for Q3. New product introductions and DIY growth were not enough to counter our large exposure to industrial-focused customers. They're still declining but sequentially improving, as I mentioned previously.

Now e-commerce continues to see strong momentum, and we saw that experience throughout the quarter driven by impressive exponential growth across all regions. This channel represented approximately 18% of the global Tools & Storage revenue for the third quarter. As we continue to expand our market-leading share position in this strategic channel, we are making targeted investments to bring in world-class talent and expand our digital capabilities to maximize this rapidly accelerating opportunity.

So in summary, despite a very dynamic environment, it was an outstanding quarter for Tools & Storage. The business delivered a record operating margin rate, executing on the cost actions while demonstrating the agility to meet the strengthening demand that emerged throughout the quarter. Great work by our Tools & Storage team.

Turning to the Industrial segment. Total growth was negative 7%, which included a 10-point benefit from the CAM acquisition, and currency contributed a positive 1%. This was offset by an 18% decline in volume. Despite the significant organic declines, we are cautiously optimistic in the positive sequential improvement in the markets across [many] industrial businesses, with automotive showing the largest Q3 sequential improvement. Operating margin rate was down year-over-year to a respectable 12.3% as the impact from market-driven volume decline was partially offset by swift cost control. Our cost actions are having a significant impact and contributed to a 350 basis point sequential improvement in the margins.

Let's now dive a bit deeper into this segment. Engineered Fastening organic revenues were down 14%, driven by lower global light vehicle and industrial production. The declines were experienced across all regions.

Although global light vehicle production remain down 5% year-over-year, forecasts continue to improve. As a result, automotive fasteners experienced strong sequential improvement from April, relatively in line with this mid- single-digit decline in light vehicle production. However, our auto systems business is still experiencing significant declines in the low 20s as OEMs continue to conserve capital in response to the current market environment.

Industrial fasteners declined high teens. And despite more positive indications for global industrial production, recovery in these markets have not bounced back as quickly. Our customer insights indicate that the majority of the manufacturers are balancing the initial surge and pent-up demand following the Q2 closures with a slower trajectory towards normalized business activity.

Infrastructure declined 25% due to lower volumes in Attachment Tools, which was down in the high teens, while Oil & Gas declined 35% due to a sharp reduction in pipeline project activity. While the outlook for Oil & Gas remains challenged, we are beginning to see positive signs of an improving environment in Attachment Tools.

And finally, let's turn to Security. Total revenue was relatively flat versus prior year, with volume down 4%, partially offset by benefits from both price and currency. North America declined 3% primarily due to lower installations in commercial, electronic security and health care due to the pandemic.

Europe experienced a modest organic decline as growth within the Nordics and France was offset by lower volume in the U.K. However, global backlog remains in a healthy position and is up versus the prior year, while order rates in electronic security have continued to gain strong momentum since Q2.

One item to briefly note before I cover margins related to Security. During Q3, we reached an agreement with Securitas to sell commercial electronic operations in 5 countries in Europe and emerging markets. These businesses represent approximately $85 million in annual revenue, and the divestiture will be modestly accretive to segment margins going forward. This decision represented normal portfolio pruning and will allow our Security team to focus their efforts and resources on our geographies where we have strong market positions.

Now in terms of profitability. The segment operating margin rate was up 10 basis points to 11%, as price and cost control more than offset the impact from lower volume and growth investments. We delivered this margin expansion and funded growth investments with a 90 basis point expansion in our gross margins, another very positive sign of the business transformation underway.

As the market normalizes and we ramp up the new growth opportunities within health and safety, the Security business is well positioned to return to organic growth and consistent margin expansion as we head into 2021.

So in summary of all our businesses, a very strong quarter as we continue to navigate the uncertainty in the current environment. As I take a step back and reflect, I am so proud of how our team stepped up during the crisis to position the business for success.

Our Industrial business, hit with the steepest market declines, is on track to deliver double-digit margins this year, a far -- far approved from the 7% margin prior-recession trough in the Industrial segment experienced by Black & Decker during 2009.

Security has taken swift actions to return to margin expansion and is now focused on accelerating its transformation with several exciting growth initiatives.

And of course, what a performance by Tools to reposition its margin potential during this downturn while simultaneously investing in programs that can keep us on the offensive as it relates to growth and share gain.

Let's now briefly look at how this translated into free cash flow performance on the next page.

On a year-to-date basis, our cash generation is $391 million, which is $412 million ahead of the prior year. The strong performance was driven by approximately $600 million of free cash flow generated in the third quarter. Our cost focus, combined with the surging demand in Tools & Storage, resulted in strong earnings growth, lower working capital versus the prior year and reduced capital expenditures.

As we look ahead into closing this year, our priority is to ensure we maintain appropriate levels of working capital to support the continued strong growth for Tools & storage into 2021 as well as market recoveries in our other businesses.

As a result of this key priority, our plan assumes $300 million of incremental working capital in Q4, which will reduce our normal seasonal working capital benefit versus prior years. Even considering this planning assumption, we expect to generate a significant amount of cash in the fourth quarter, and our planning assumption is for $800 million to $900 million of free cash flow for the full year 2020.

From a capital deployment perspective, while we have removed our explicit pause on M&A and share repurchase, our priority today is deleveraging in line with our strong investment credit ratings.

In terms of our liquidity and balance sheet, we ended the quarter with full access to our $3 billion commercial paper facility and approximately $700 million of cash on hand. As a reminder, we do not have any long-term debt maturities until late next year. So as you can see, we have maintained flexibility from a liquidity standpoint.

I would now like to discuss the third quarter exit trends for demand and how we are planning for the fourth quarter.

On Slide 8, I will start on the left side of the page and walk through a segment view of our fourth quarter planning assumption range. I will also provide color on the geographic or key business exit trends. In this case, I will use September and October month-to-date actual shipments as our exit trend, which normalizes for various timing factors.

For Tools & Storage, we are planning for a fourth quarter range of 8% to 10% organic growth. One key assumption in the Tools & Storage range continues to be the sustainability of the strong demand within U.S. retail.

I'm happy to report that POS in North American retail has remained strong. While demand is lower than some of the stratospheric levels we experienced in Q2, the POS growth has remained very strong in the low 20s for the prior 4- and 8-week period. POS for the most recent 4-week period for brands such as Craftsman and Stanley are delivering similar levels of growth that was demonstrated over the entirety of the third quarter. POS growth within our more pro-focused brands, such as DeWALT and Stanley FatMax, have accelerated in recent periods, reflecting the positive trajectory of the pro recovery, which gained momentum as the third quarter progressed. Our planning range assumes that POS will be maintained in the mid-teens to the low 20s for the entire fourth quarter.

The recoveries in Europe and Latin America accelerated in the third quarter, and we continue to see positive momentum. However, we are planning for a moderate deceleration of shipment growth from Q3, factoring in the inventory recovery that occurred for these regions.

Finally, the U.S. commercial and industrial channels, along with Asia, should continue to see sequential improvement but are planned at slower trajectories compared to the other channels and regions within this segment.

The revenue trends in the Tools business for the last 8 weeks support our view of continued strong performance as we've experienced growth of 12% in this time horizon. This is slightly above the high end of our planning range for Q4. However, we anticipate the deceleration in the international markets primarily to occur over the remainder of the quarter.

For Industrial, our plan assumes for an organic decline of 10% to 15%. Many of the end markets are demonstrating continued recoveries. The exceptions are aerospace and Oil & Gas, which are longer cycle, and we are planning for protracted recovery. On the positive side, we have continued to see improvement in automotive production forecasts, industrial production trends and order momentum in Attachment Tools. Our midpoint would assume continued improvement within automotive, Attachment Tools and general industrial end markets versus Q3.

The revenue trends for the last 8 weeks support continued recovery for this segment as our shipments were down 11% organically, in line with the more optimistic end of our Q4 planning range. Another positive signal is that Engineered Fastening has demonstrated organic growth over the last 4 weeks. Market momentum and easier comps in this segment are starting to emerge.

Turning to Security. Our plan assumes for a range of down low single digits to a high end of being relatively flat organically. Exit trends for this business are tracking relatively in line with this range, which is a good result considering that Security grew 4% organically in Q4 2019.

Although the recovery continues to be mixed by country, backlog remains strong and orders have been regaining momentum, which supports an opportunity for sequential improvement with installation and maintenance activity. Additionally, the business is focused on stimulating demand with their existing and new health and safety solutions, which have emerged from the pandemic and will begin to generate revenue prior to the end of the year.

As you aggregate this for the total company, we are planning for a Q4 range of 3% to 5% organic growth. The low end of this range represents a moderation in the strong POS within U.S. retail or a meaningful deceleration in the recovery trajectories in industrial Security for the remaining tool markets.

The high end of our range reflects continued positive momentum in the recovery and with North American POS levels continuing to be strong. We currently are not planning for an improvement in store inventory levels within this range for our Tools & Storage major customers.

The company revenue trend is up 7% organically across September and October month-to-date. Considering we would expect it to be a little stronger initially due to the monthly timing in Tools previously mentioned in our revenue range, it is a reasonable expectation at this stage for the fourth quarter.

Now moving to Page 9, I would like to provide an update on our cost program. As a quick reminder, we targeted 4 areas of opportunity: indirect spend, compensation, benefits and raw material deflation. We are on track to capture the previously outlined $500 million 2020 benefit. During the third quarter, we realized $175 million of the benefit, which brings our year-to-date savings to $350 million.

The organization continues to make progress on improving the sustainability of our cost action.

As you think about the program heading into 2021, we are still on track to deliver a positive carryover of $125 million, net of costs associated with restoring the temporary cost actions implemented earlier this year. In addition to this positive carryover, we continue to execute on our margin resiliency initiatives and expect to see an opportunity for $300 million to $500 million over the next 3-year period. A reasonable expectation for the 2021 margin resiliency opportunity is a range of $100 million to $150 million.

As a reminder, we view this program as an incremental source of contingency to offset any unforeseen headwinds that may arise throughout the year, support investment into the business or support margin expansion and outperformance.

Now I will quickly summarize our 2020 planning assumptions on Slide 10. From a revenue perspective, as I mentioned, we see a potential for a range of 3% to 5% organic growth in the fourth quarter. From a cost structure perspective, we had $180 million of 2020 savings from our Q4 2019 cost reduction program and expect an additional

$500 million from the cost actions announced earlier this year, as I just mentioned. Tariffs and FX are currently expected to be a $165 million headwind, with $140 million of that behind us through 3 quarters.

Considering these factors, we are planning for a full year operating margin dollar growth in the mid-single digits and significant margin rate expansion versus the prior year.

Finally, we have disclosed our assumptions for the below-the-line items as you work to model various business scenarios. When you evaluate all these financial factors and complete the math, the result will be an EPS range centered around our 2019 EPS result of $8.40 per share, an excellent potential outcome given where the world was 6 months ago in the depths of the crisis.

From a cash deployment perspective, our near-term focus is deleverage. We are maintaining our capital expenditure reductions while continuing to invest in the key areas that drive growth, margin resiliency or support footprint moves in Tools & Storage. We will keep a sharp focus on working capital management and have aligned our supply chain to serve the strong revenue growth.

I know many of you are thinking about 2021 at this point. As outlined earlier, we have built approximately $125 million of positive carryover from our cost program and have margin resiliency at our disposal to serve as a contingency. In addition, as Jim mentioned, we don't see major headwinds or tailwinds from an input cost perspective at this stage. Therefore, this sets up nicely to handle a significant amount of cost headwinds should they emerge or outperform expectations if these headwinds do not emerge.

As it relates to revenue, our visibility has improved, but it's far too early to comment on market demand for 2021. That being said, we don't accept the notion that our setup is a story about insurmountable comps.

Consider that in 2020, approximately 25% of the portfolio is expected to show double-digit, market-driven, organic retractions mainly concentrated in industrial-focused end markets across our segments. It is reasonable to expect growth from an arguably easy set of comps in this category. 20% of the portfolio is showing modest retractions this year in addition to the 25% I just mentioned. This would include Security in some of our emerging market geographies and Tools. These businesses certainly don't have tough setups as we sit here today and appear poised to be able to demonstrate growth.

The remaining 55% of the company, which includes North American retail and European Tools & Storage, will show growth this year. But the setup for the front half of 2021 is very good as they retracted organically in the comparable period in 2020 due to the shutdown and inventory corrections that we experienced. These markets have continued to stay strong and the refocus on the home trend has emerged and continued.

Finally, we have a host of growth catalysts that Jim will outline in a moment. We believe we have the investments and the initiatives in place to drive the next leg of share gain across our businesses. When considering all these factors and, of course, assuming no adverse changes in market demand due to major economic pullbacks, we do not see any reason at this point as to why we cannot demonstrate organic growth in each of our segments in 2021. So hopefully, this helps you see why we are excited with the potential for the company to create significant shareholder value in 2021 and beyond.

Thank you and I will now turn it back to Jim.

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

Okay. Thank you, Don.

Like I said before, no one could have anticipated the ups and downs and the twists and turns this year would take, and it looks like it's going to be a great outcome. Well, look, we've covered a lot of ground already, and so I'll just take a few more minutes to highlight our growth catalysts.

The Craftsman brand rollout remains a key element of our growth strategy, and the surge in DIY, outdoor and positive trends in e-commerce have further accelerated this opportunity. And by the end of the year, we expect to deliver $900 million of cumulative growth from this program since acquisition and about $100 million ahead of our latest plan. And with more Craftsman growth opportunities on the horizon, we can reiterate our commitment to achieve the $1 billion revenue target 6 years earlier than we committed during our initial acquisition announcement. We can now start to evaluate how much further we can go beyond $1 billion over the course of time, especially with the potential addition of outdoor power equipment through MTD.

The MTD opportunity gives us an option beginning in the middle of the next year to acquire the remaining 80% of one of the great American outdoor power equipment companies in an all-in multiple that will be in the 7 to 8x EBITDA range. We continue to be encouraged by their product development pipeline as well as their progress on improving profitability. That category is experiencing similar benefits from the consumers' reconnection with the home, and we continue to be excited about the runway for growth by leveraging brand, technology and channel synergies. This combination has the potential to generate significant shareholder value by expanding our presence in this $20 billion-plus market. And everybody understands how the pandemic has accelerated the consumer shift to e-commerce.

In Tools, we are the industry leader in this channel by a factor of approximately 3x, and we've been working on it for 10 years, building e-commerce partnerships with major players all around the world. Over that time frame, it has evolved from nothing to representing at least 18% of sales, up 5 points this year alone. We're investing in new talent, digital capabilities and our brands, including the revitalization of the Black & Decker brand, to capture this compelling opportunity. And we have the products. Despite all the cost actions, we are continuing to invest in our product innovation machine, bringing new core and breakthrough innovations to the market.

In Tools, we continue to strengthen our position as the industry leader in maximizing power output with innovations like DeWALT POWERDETECT and FLEXVOLT ADVANTAGE. The extension of our innovative ATOMIC and XTREME power tool platforms into new products and categories is providing more solutions for users to expand their toolkits with the highest power-to-weight ratios available in the market.

And the societal obsession with health and safety that we're all experiencing right now has created new opportunities for Security. Our transformation came at the right time as Security is leveraging capabilities that have been developed during the last 2 years such as digitally proficient talent, technology and partnerships to commercialize new solutions. These are products such as automated entrance management with facility threshold controls, contact and proximity tracing and touchless stores for commercial establishments that will begin to show revenue in 2021.

And taken together, these growth catalysts have the potential to generate over $3 billion to $4 billion of revenue annually over a multiyear period. The shareholder value creation potential is compelling over the medium to long term. And as for the short term, it was a remarkable quarter and one for the record books. Despite the pandemic, we are running on all cylinders. The fourth quarter looks to be strong, as Don pointed out, as well.

I want to thank you all for your interest and support as well as thank our Stanley Black & Decker leaders and their associates for their commitment and effort as we look ahead to our next chapter, which we expect to be a powerful growth story with significant margin accretion potential.

And Dennis, we are now ready for Q&A.

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

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

QUESTIONS AND ANSWERS

Answer – Operator: (Operator Instructions) Our first is question is from Jeff Sprague with Vertical Research.

Answer – Jeffrey Todd Sprague: A bunch of questions. I guess I'll trust those behind me will ask the ones I don't.

I want to focus in on margins a little bit more, if we could, and just understand if there was anything really unusual in the Tools margin in the quarter.

And then just thinking about what you're suggesting for organic growth, it looks like it would put Tools revenues in Q4 similar, maybe up slightly from Q3. So maybe you could just give us a little additional color on margins specifically in Tools & Storage in Q3 into Q4.

Answer – Donald Allan: Sure, Jeff. So yes, I mean, the third quarter margins, as we mentioned, were really outstanding at 21.5%. And there was nothing unusual in there or onetime in nature. It was really a demonstration of the significant amount of costs that we took out very quickly back starting in March and April time frame of this year. A lot of that was temporary, then we did a very quick pivot, if you remember back, in June and July to convert a large portion of that to permanent cost actions and make it sustainable going forward because we recognized the volatility of the situation. And we're really starting to see the benefit of those cost actions flowing through the margins and maintaining our cost base at this level as we see the strong top line growth and get outstanding operating leverage as a result.

And let me just be clear for those of you wondering if we're just cranking up the plants and that's resulting in some unusual benefits to margins that's not the case. The way that, that accounting works, it actually gets hung up on your balance sheet for almost 6 months, and you don't really see that benefit till later on down the road. So we're not seeing that benefit because I know that's probably a question some of you have. It's really just what I mentioned, it's really focused on the cost actions we take and -- we took and the benefit of operating leverage associated with that.

On the organic growth part of your question, yes, I would say we're probably looking at a similar Q4 to what we just experienced in Q3 for Tools and, frankly, for the company as well overall. And we'll see how that plays out. We've got a great start to the fourth quarter. We really feel positive about the performance in the month of October. But we also know that in the fourth quarter, the heavy revenue months are really -- the biggest one is October and then the beginning of November is pretty strong, too. So it's great to have that start at the beginning of the quarter.

Answer – Operator: Our next question comes from Deepa Raghavan with Wells Fargo Securities.

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

Question – Deepa Bhargavi Narasimhapuram Raghavan: I'll stick with the margin theme here, too. Don, you noted Tools & Storage margins have stepped up higher. Can you talk about how much of that structural lift in margin sticks over the medium term? That is, how much higher than the 17% T&S margins we should be expecting on a go-forward basis here?

Also, a quick clarification on 2021 margin resiliency measures of $100 million to $150 million. Will that be pulled only if things deteriorate versus your plan? Or will that be layered in irrespective?

Answer – Donald Allan: Sure, Deepa. So on your first question, the -- we really are very focused right now on how do we take this step change in margin rates for Tools and do our best to make a large part of it sustainable. And I really think when you see the Q4 result, and actually when you do the math and you start to think through the models, you're going to see that the margin rate in Q4 is going to be, although not as high as Q3 because we do have a normal tick down due to some holiday mix factors that occur in the fourth quarter, but still it will be around 20%. It'll be a very strong margin rate for the fourth quarter for Tools & Storage.

When I think about going forward into next year, we are now looking at this business as being a very high-teens margin business, and we want to be able to maintain that going forward. And so that's our view at this stage.

And they will exit the year around 18% for the full year for margins, and we would expect them to continue to be somewhere between 18% and 20% next year barring any unusual things that -- or headwinds or things like that, that we're not expecting at this stage.

As far as margin resiliency, that -- we're going after that number no matter what. So these are things associated with Industry 4.0, commercial pricing excellence, some of the plant moves we're doing around the world to streamline our operations, et cetera. And so we will aggressively go after that $300 million to $500 million over the next 3 years, $100 million to $150 million for 2021. And so it sets up a nice contingency if we need it. And as I said in my script, if we don't need it, it'll help us either make some investments or have an outperformance or a mix of both.

Answer – Operator: Our next question comes from Josh Pokrzywinski with Morgan Stanley.

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

Question – Joshua Charles Pokrzywinski: I'll just shift over to growth and, Don, one comment you made about the lack of contemplated inventory replenishment. I know we're kind of talking about percentages of percentages given that it's really just a phenomenon that's present in U.S. retail. But I think some of Jim's earlier comments dating back to other points in the third quarter suggest there's maybe 4 or 5 weeks of inventory that could use replenished at some point. My math would say that on the totality of Tools & Storage, that's still kind of a mid- to high single-digit percentage of any given quarters of growth potential. Is that something that we see stretching out here into the first half of '21? And is that kind of the right order of magnitude to think about what that restock means in terms of segment organic growth?

Answer – James M. Loree: Yes. The -- it's Jim. I know you directed it towards Don, but I feel lonely because everybody wants to talk about margins and I'm not an expert on -- I mean, I know how to make them expand, but I'm not an expert on the details of the margins. So I'll take that one.

And we've had a lot of customer contact with our partners who have these inventories that are not where they want them to be. And the fill rates are not exactly where they want them to be, although I think we're doing reasonably well in relation to their typical suppliers. So there is this replenishment of -- and I think you're in the right zone, about 4 weeks or so of inventory that we would all -- customers and us would all like to replenish, but keeping up with the POS at the levels that it's at right now is really a challenge. So yes, I think you've got it right in the sense that it's not going to be solved in the fourth quarter and the customers are very, very clear about it must be solved in the first quarter. And we hope to be able to do that and to fulfill their needs. Thank you.

Answer – Operator: Our next question comes from Julian Mitchell with Barclays.

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

Question – Julian C.H. Mitchell: And apologies, Jim. Maybe one more question on the margins. So looking at it from maybe 2 parts, I suppose.

In 2021, understand that -- the margin resiliency and the carryover sort of net of temporary actions. But should we expect much in the way of things like outright new selling costs coming back or R&D perhaps stepping up? Or are those sort of all included when you talked about a reinstatement of actions?

And also, beyond '21, broad thoughts on incremental margins in Tools. What do you think your entitlement is there when you consider competition, the channel but also your margin resiliency efforts?

Answer – Donald Allan: Yes. I would say that if you look at the back half of this year for Tools & Storage margins, we're clearly benefiting from some amazing operating leverage that most likely we will not get that magnitude of operating leverage next year because we will do some of the things you mentioned. We will continue to invest in growth, and so we may not have 21.5% or 20% margins like we're going to have in the back half of this year. But we believe we're going to have margins that, as I said, are somewhere between 18% and 20%. So pretty robust margins as we make some of those investments, which means our operating leverage will still be very, very strong, probably somewhere between 30% and 40%, leaning to more towards the 40% next year and pretty robust.

And so I think we've positioned our cost base. We're positioning our manufacturing footprint as we continue to make changes to that as well as expand some capacity in certain areas around distribution and manufacturing to allow us to make sure that we continue to have that type of leverage as we're able to benefit from the significant growth environment, which has the potential to continue for much longer than the first 3 to 6 months of next year. We'll see how that plays out and whether there are certain factors like a U.S. stimulus and other things that continue to drive that type of performance.

But there's a lot of activity, as you know, focused around the home that Jim touched on and e-commerce as well. And so we're really trying to prepare ourselves for that type of environment that may continue for maybe 12 to 18 months. And as a result, I expect to see very strong margins throughout next year in the range that I mentioned.

Answer – Operator: Our next question comes from Michael Rehaut with JPMorgan.

Analyst: Michael Jason Rehaut, JPMorgan Chase & Co, Research Division - Senior Analyst

Question – Michael Jason Rehaut: I just wanted to get a finer understanding on the promotional sales shift, number one, in Tools & storage. The -- looked like it was -- you're expecting another 4 to 5 points of growth in the third quarter, but now that shifts into the fourth quarter. However, I'd be surprised if you were -- say, excluding that, if that normal shift had occurred or the sales were in September, I'd be hard-pressed to say you would be looking for a mid-single-digit organic growth range. So I just wanted to try to understand how that kind of works through. And also, if it has different -- if those sales have different margins being promotional sales.

And lastly, I'd just love to get some additional comments in terms of the growth opportunity you see for the company over the next couple of years in e-commerce.

Answer – James M. Loree: I'll take the latter part of your question, and Don will take your -- the former part.

Answer – Donald Allan: Okay. So yes, so the -- if we go back to the Tool shift from Q3 to Q4, about 4 to 5 points, as I mentioned and you mentioned as well, so yes, when you think about the dynamics of what's happening in the fourth quarter, we're getting a really strong surge here in October. Some things had shifted from the month of September to October. And when you look at the performance for the full quarter, it's going to be a similar type of result as what we experienced in Q3.

So if that 4 to 5 points had shifted into Q3, we'd be kind of looking at a mid- to high single-digit performance in Tools & Storage for the full quarter. But that factors in a lot of different things. You have to recognize that although POS in North America is strong, and we're assuming it's somewhere between kind of mid-teens to low 20 percentile, other things are -- the growth is deselling in certain parts like the European markets, the emerging markets. We saw some inventory kind of stocking and restocking in those geographies that will not repeat itself here in the fourth quarter. So although we'll see growth, it won't be of the same magnitude we saw there.

And then we still have some portions of the business that are retracting, although retracting at slightly lower percentages than what we're seeing -- what we saw in Q3. We still have that as a factor as well. So when you pull that all together, that's kind of how you get to that net result at the end of the day. Jim?

Answer – James M. Loree: So on e-commerce, obviously, we're very excited about this topic because when it was not very popular, we were kind of a couple of yards and a cloud of dust, just workmen like going after it, building it, 0 and -- almost 0 in kind of 2010, and today we're knocking on the door of $2 billion in e-commerce. And the profitability is good. It's not something that you can worry about negative mix. The profitability is good. The cost to serve is actually reasonable vis-à-vis other channels, and gross margins are excellent.

So today, we have a vast network of partnerships around the world with major e-commerce players, and we're very pleased with that and proud of that, ranging from Alibaba to Amazon to -- and some of the regional players and so forth. It's all B2B2C as opposed to D2C, which is okay for us. It's worked well. And frankly, our competition has more or less shied away, have not really made it a strategic focus in general. So we sit here today in a very good place with strength.

And so we're not naive to think that the competition is not going to jump in. Of course, they are. But we are going to double down in this area and have already constructed $75 million worth of investments over the next year or 2 to strengthen our position in e-commerce. And one of the big initiatives is the Black & Decker brand revitalization. It's probably a little known fact, but the Black & Decker brand is -- plays extremely well with the younger generations, and, of course, younger generations are the core of the e-commerce growth in the future.

So with Jeff Ansell running this Black & Decker revitalization initiative in partnership with a major e-commerce player in North America is kind of one of our elements of the strategy. And then we also have significant investments in the core, so strengthening the core e-commerce that we have as well with additional resources, additional focus on content creation and market development. And then also initiatives, pretty significant initiatives in Germany, China and India, all D2C.

So areas where our share is not -- where we're underindexed, if you will, from an existing channel perspective, going D2C in those markets because we have very little to lose, especially in China and India, and really excited about this. I think e-commerce is going to be a major, major growth driver for many years to come.

Answer – Operator: And our last question comes from Joe Ritchie with Goldman Sachs.

Analyst: Joseph Alfred Ritchie, Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst

Question – Joseph Alfred Ritchie: So I wanted to maybe stick on growth for my one question. When you guys issued the -- your 8-K intra-quarter and 3Q, I think you guys were calling for high teens T&S growth and recognize the promotional activity was 4 to 5 points. And so I was wondering if you can maybe just elaborate what else changed relative to your expectations earlier in the quarter.

And then specifically, I've heard you call out international decelerating in inventory levels. Just any more color around that specifically would be helpful.

Answer – Donald Allan: Yes. I would say that when we did the announcement back in late August, we said Q3 for Tools, we see kind of a high teens performance for organic, and we talked about the reasons for why it's different.

We also communicated that we expected Q4 to have kind of low single-digit growth. So we're indicating that the back half would probably grow somewhere around 7%, 8%, in that range. We're now looking at a back half that's going to grow around 10% and potentially a little bit better if some of the trends continue here in Q4 that we saw in October.

So we're seeing a better growth profile for the back half of the year in total versus what we thought about 1.5 months ago or so for the Tools & storage business. And a large part of that is the continued strength of North American retail and what we're seeing there with POS. And although we do have some deselling in Europe and so the growth number will be lower but still very good versus Q3 because Q3 was pretty robust and kind of mid-teens number for growth, we'll probably see something that's closer to half of that in our European markets. And that factors in some of the inventory stocking that we saw in Q3.

So the things that have really shifted are that we were able to recognize how much inventory was built in our customers throughout the third quarter, and there was a significant amount in some of the international markets and very little in the North American retail channel. And then here in the fourth quarter, we see the dynamic of not having -- as I said, we're not really putting any inventory build in the fourth quarter. At the end of the day, could there be a little bit in the North American retail channel when we're done? Maybe, but it's probably going to be pretty modest, to the point that Jim made when he answered this question earlier.

The bigger part of the adjustment is going to happen in Q1.

Answer – Operator: This concludes the question-and-answer session. I'd now like to turn the call back over to Dennis Lange for closing remarks.

Answer – Dennis M. Lange: Shannon, thanks. We'd like to thank everyone again for calling in this morning and for your participation on the call. Obviously, please contact me if you have any further questions. Thank you.

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