Wolfe Research 13th Annual Global Transportation Conference

Company Participants

- James M. Loree, President and Chief Executive Officer

Other Participants

- Nigel Coe, Analyst

Presentation

Operator

Good morning and welcome to the Wolfe Research Virtual Global Transportation & Industrials Conference. This is the Stanley Black & Decker Panel hosted by Wolfe's senior analyst covering electrical equipment and multi-industry, Nigel Coe. (Operator instruction).

I'll now hand the call over to Nigel.

Nigel Coe {BIO 3818998 <GO>}

Good morning. Thanks for joining us this morning. We're very pleased to be hosting Jim Loree, President and CEO of Stanley Black & Decker. Jim, thanks for the time. Jim's been in CEO seat now for 3.5, maybe a bit longer, years, after many years as Chief Operating Officer. I think I might be one of the few analysts covering your stock who remembers Jim as the CFO, which was a very long time ago.

Jim really has been instrumental in turning Stanley from what was an underperforming hand tool company 20 years ago into the company that we see today. So this is a fireside chat. Please feel free to log any questions in the textbox or email us on coeteam@wolferesearch.com [ph] and all questions will be fielded on anonymous basis.

So Jim, I know you have some prepared remarks. So over to you. Thank you.

James M. Loree {BIO 1939736 <GO>}

Thank you, Nigel. And thanks, everybody, all the attendees. I'd like to start with the first slide there, cautionary statements and then moving on to how we've been handling the company during this pandemic. And we started out very early with four priorities, the first being ensure the health and safety of our employees and supply chain partners. And you can imagine that without that, you have nothing else.

And with that, you have the trust of the employees, and the trust of the employees willing to come to work and that enabled us to maintain business continuity from the get-go starting with the China situation where we have eight plants and -- 10 plants and 8,000 people, and we went through and learned an awful lot during that timeframe on how you keep the employees safe in a production environment. And so the Chinese experience for us as we went into that pandemic and through it was pretty incredible. We ended up with only one confirmed case of COVID-19 based on the strength of our procedures and our protocols for safety.

So during that early days, we also had to deal with the questions about what was going to unfold here in terms of the demand scenario. So on one hand, keeping the supply open; on the other hand, trying to figure out what the demand was going to be on a short-term, medium and long-term basis. And, of course, that's really hard to do when you're living in the unknown with so many variables. And so we ended up with doing some scenario analysis. We looked at our liquidity. We've taken some actions to strengthen our liquidity. It was already very strong. And we feel really good about the liquidity situation.

And then we were looking at the different scenarios for volume and kind of fixed in on a base case of minus 35 to 45 for the second quarter and then getting better as the year unfolded. We weren't sure, still aren't sure, whether it was going to be a V, a U, or an L-shaped recovery, but we had scenarios covering all those. And in the end, we decided that we would take out $1 billion of cost to make sure that we had the financial strength.

Our approach is always through these kinds of downturns, and I've been through a few of them now, has always been going strong, stay strong, and then come out stronger. And so that's what we did in '01-'02, that's what we did in '08-'09, and that's what we'll do this time around. The financial strength and the continuity of our companies during this timeframe has enabled us to serve our customers well and our customers in many cases are labeled as essential services or products providers as are we, and so as our customers go, sort do we, and I'll touch upon some of the trends in that area in just a few minutes.

Then the last thing, and it's really important. We're a company that really believes in social responsibility and having a positive impact on society. And never has that been more important in my tenure than now. And so we've made that a very significant point of emphasis.

Next slide, Cort. So I'll stop in terms of the big picture for just a moment and comment on what we're seeing from a revenue point of view and how that might be different from our initial 2Q estimate as Don Allan described yesterday and we released in an 8-K. But this is a little more detail on it. So in the initial estimate that we shared after -- or during our first quarter analyst call, we were looking at revenue down 35% to 45% for the second quarter. We suspended guidance for the year, still have suspended guidance. So we were trying to give some indicative information for the second quarter to help everybody with a transparent view on what we knew.

And at the time, we were looking at four weeks of April sales that were down 40%, and we were looking at April POS that was in North America retail that was up substantially. But we had a pretty significant disconnect between the order rates from our key North American retail customers, especially the large ones like home centers and e-commerce. And so subsequent to the fourth week in April, which was the last data we had available and is what we shared that estimate, subsequent to that POS has really begun to accelerate on a weekly basis. And shortly after that, the sales, the sell-in orders and sales began to accelerate enabling us to upgrade our forecast to minus 20% to minus 30% organic in the second quarter with a bias towards the more favorable end of that range, which I think bodes very well for total year assuming all else equal. So there's other things to consider for the total year.

And so, if you think about the businesses, I mean a lot of this is driven by the tools business, especially domestic US tools business, but also security. Security is not as unfavorable as we initially thought and the combination of those two things has given us essentially a 15-point movement at the midpoint of those two ranges in a favorable direction. So that better growth is really great news. Is it sustainable? We shall see over time. But right now, I'd say we're feeling pretty good about the growth picture moving forward.

Next slide, Cort. I did refer a minute ago to the cost actions that we took. It's a really substantial program. It's the largest cost reduction program I've ever done with my team and it involves a pretty substantial cut in indirect cost, which was running around $1.7 billion last year, taking out between indirect cost and deflation about $600 million of costs from indirect and direct materials and then another $300 million or so from compensation and another $100 million or so from benefits. Most of those cost actions are behind us at this point in time. We're not completely done with the indirect cost, although we're very close to having visibility to the kind of the numbers we're looking at there.

Just a thought on this is that, because there's so much uncertainty, our base case is what we shared in the April timeframe, our base case for 2020 revenues. And we also had an upside case, and we also had a downside case. And right now, I would say, we are standing on the base case sort of moving toward the upside case. The $1 billion was programed to provide strong financial performance in the face of the kind of volume decrease we were expecting in the base case. So this $1 billion will provide even better financial performance as we lean towards the upside case.

Cort. And the last thing I want to hit upon here is the thing that's most exciting and interesting from my point of view, which is I don't think -- call it luck, call it a little bit of foresight, whatever. We took so many actions on growth in '17, '18, and '19 to prepare us to do extremely well during an environment where the home centers, e-commerce, and outdoor were important facets of growth. And so the entire CRAFTSMAN project, which is a $1 billion project -- to be a $1 billion project before long, the FLEXVOLT innovation that we put out in the marketplace a few years ago, the Stanley FATMAX swim-lane changes in the home centers and then DEWALT Atomic and DEWALT Xtreme the power tool, highest power-to-volume ratio in the tool industry, breakthrough innovations out in the market last year, well over $100 million last year and growing and e-commerce. We are by far the e-commerce leader in the tool industry with $1.3 billion of volume in e-commerce last year.

You saw the home center numbers over the last day or two. You know how well they're doing. You know how well e-commerce is doing in this environment. We are exceedingly well positioned to leverage the trends that are going on in the channels to take share, and we are taking share unequivocally in this marketplace. And then looking forward, we're very excited about the MTD program, which gives us an option to acquire the remaining 80% of MTD, one of the great American outdoor power equipment market leaders based in Ohio. And MTD and we have been working together to help improve their profitability and to help grow their product lines with new and exciting brand assortments for the future.

So lots of growth catalysts either to buffer the shock of a recession or in the event that we should return to normal at some point in time, really give us more outsized growth like we've been experiencing prior to this dislocation. So those are my prepared remarks, Nigel. And I'll give it back to you now.

Questions And Answers

Q - Nigel Coe {BIO 3818998 <GO>}

Great. Thanks, Jim. That was a great summary. So obviously, the more information and data you give, the more we want. So just want to make sure we're thinking about it the right way. So the fact that you talk about industrial trending very much in line with what you laid out in April, that doesn't surprise me whatsoever. But I'd be curious what changed between the time of earnings and now, in the three weeks? Is it simply a case of the big-box channels stocks cutting inventory, we subsequently saw Home Depot and Lowe's cut inventories pretty aggressively. Is it as simple as that?

A - James M. Loree {BIO 1939736 <GO>}

That's the most significant answer. But the POS is accelerating. It's at levels that I have never seen in 20 years. So that could not be predicted. The POS part of it could not be predicted, because that all occurred in the last three or four weeks. But the caution in inventory that some of the home centers exhibited made perfect sense at the time, because they didn't have the POS at those levels either. So in supply chains, as we all know, that's what happens. There's a kind of a boomerang effect going down and going up and that's what we're seeing.

Q - Nigel Coe {BIO 3818998 <GO>}

So POS trend specifically is people spending more time at home. They've got money in their pockets because the government is (inaudible) income. The annoying DIY projects are starting to wear [ph] them. And so is it as simple as that?

A - James M. Loree {BIO 1939736 <GO>}

Well, I think you certainly can point to the DIY coming alive as the single biggest factor. All these folks at home, looking for things to do in some cases, there's pent-up demand for projects in the home and people are doing projects. And it's a nice sideline to distraction from some of the boredom that some people are experiencing during this timeframe. So I think that is the single biggest factor. The thing that gives me some encouragement is that the pro has not been as prevalent in the home centers, in my opinion, as it normally is with construction levels down and projects on hold and so forth, not all projects but some projects on hold.

And so I think as the DIY saturates and as stimulus kind of abates and so forth, I think you're going to see a resurgence of the pro in the home centers, which hopefully will give this run some further legs. I don't know that it's going to be at the levels we're at now, which are just spectacular levels, biggest I've ever seen, highest I've ever seen.

Q - Nigel Coe {BIO 3818998 <GO>}

And obviously, given the cutback in the inventory levels and the fact that POS is accelerating, I'm assuming that's creating some shortfalls in certain categories within your customer channels. Number one, how prepared are you for this potential surge in orders? And kind of how long do you think this trend is going to continue? Obviously, you don't want to extrapolate too far, but any signs of that might be sort of weighing this impact?

A - James M. Loree {BIO 1939736 <GO>}

Yeah. Fortunately for us, because we didn't really know -- we were smart enough to know that the disconnect between POS and sell-in was probably not going to last forever, even though we couldn't and didn't put it in the forecast for external consumption. But we did build buffer stocks given the possibility that there could be a surge. So I think we're in pretty good shape.

Obviously, we're looking at this every week. And we have Asia -- a good part of the volume comes from Asia and China specifically. So there is some lead times. But the fact that the home centers were able to decrease their inventory levels gave us some time to get production up and running, so that we could produce the buffer stocks.

So we feel pretty good. My team and I had a lot of conversations about the one thing we can't let happen is being unable to serve our customers, if in fact there is a surge in orders. And so I think we've got that covered.

Q - Nigel Coe {BIO 3818998 <GO>}

Okay, good. I can't believe we're talking here about not being able to settle orders. I mean, (inaudible) kind of environment. But if we think -- I mean, again, I don't want to spend too much time talking about the sales numbers. Those (inaudible) by yourself and also by Don yesterday. But if we think about industrial down 40%, security clearly is tracking a little bit better. It feels like tools are tracking maybe down mid-single digits in May. Is that the sort of zone and you're comfortable with?

A - James M. Loree {BIO 1939736 <GO>}

I'm comfortable that because the April sales in total were down 32% that kind of gives you an indication where tools will probably be somewhat lower than that and they're getting better now. So if you follow that logic, you kind of get to the zone that you're in.

Q - Nigel Coe {BIO 3818998 <GO>}

Okay, great. And then you mentioned the cost reductions of $1 billion in your slides. It seems that you're managing the discretionary under that to a down low- to mid-20s decremental margin. Is that a good way to think about it, or is the more favorable tracking on sales given there's some upside scenario on decremental margins?

A - James M. Loree {BIO 1939736 <GO>}

I mean, I think the cost reductions will stay in place until we decide that they don't need to be in place, which would mean that things have gotten quite a bit better. So we like the direction sales are going in, but we don't know what's going to happen when and if we get a surge in more cases and maybe there's more -- maybe some more lockdowns and we go around the world and the emerging markets haven't really experienced this at the level, in general, that some of the developed markets have. And so there are so many uncertainties. How about when the stimulus expires and we have 15% to 24% or 25% unemployment? What's demand going to look like? I mean there's just so much uncertainty out there that the $1 billion quest I've got will continue for a while, and therefore, I think the decremental margin impact will be quite favorable.

Q - Nigel Coe {BIO 3818998 <GO>}

Okay, that's clear. And then security, as we've seen the companies opening up, especially in Europe where you've got a big presence in security, has that business tracked the way you expect it to, so that access to buildings has meant some of that service work is getting done? And then maybe just talk about how you see this business potentially benefiting from social distancing and employee tracking, contactless access to buildings, how can you benefit in this environment?

A - James M. Loree {BIO 1939736 <GO>}

Yeah, I think the security business, all of a sudden, has gone from being on the fence. In fact, it was just about two years ago that we put it under a strategic review and I said that we'll differ decisions on this, but I will tell you, the opportunities in security are falling off the trees. The healthcare business, which basically does all this asset tracking, people tracking, and so forth as one of its core product lines is working on projects with major customers that could be trend-setting in terms of technology. We also have a big adult living business, which provide safety and protection for folks in nursing homes. We all know the sad story of the nursing homes, and we're doing a lot of innovation in how do we protect these older people. Automatic doors, I mean, who wants to touch a door anymore. So there's all sorts of innovation opportunities there.

And then all this work we've done in transforming security to be more of a technology delivery company is also coming into play with access control and all sorts of other neat technologies that will interact with that. So I've gone from on the fence with security to I think -- we're working on a number of growth opportunities here that we will put our resources behind in the post -- during this crisis in the post-COVID world as the world has changed. And I think the security business has lined up perfectly for that.

Now getting back to the short-term trend question that you asked in the beginning of that question. North America is definitely benefiting from better access to facilities. The security business usually performs very well, and we were looking at numbers that were a little bit deeper downturn in security for the second quarter anyway than we normally would get during a downturn. And so I'd say we've gone from that to now that we've got access to more buildings, it's trending very nicely on a sequential basis. And that's what's driving kind of most of the upside in security that we're experiencing right now.

Q - Nigel Coe {BIO 3818998 <GO>}

So it sounds to me, and (inaudible), it is an important point for lot of folks. It seems that security is trending more towards being a core Stanley business if not already there. And I think one of the characteristics a core Stanley business is eligibility for growth capital, M&A capital. Would you consider expanding your presence in security over time, given some of the opportunities you discussed?

A - James M. Loree {BIO 1939736 <GO>}

Yeah, I don't know that it's going to need or want a lot of M&A capital. I think this is going to be much more of an organic story. We are doing a lot of work with venture start-up companies where we'll make a small $1 million, $2 million investment for exclusive access to technology, which we can deliver through the security distribution channel, if you will. But I don't see right this instance, I think our capital allocation priorities are still going to be directed towards tools and industrial. However, that's today's view. That could change, but I do think that we're seeing security as more strategic than we have in many, many years.

Q - Nigel Coe {BIO 3818998 <GO>}

Okay. That's clear, Jim. And then we'll stop for questions (inaudible) about maybe a couple of minutes. Obviously, you've got a big -- you still have a big China presence, China manufacturing presence. You've had a lot of headwinds related to that with tariffs and foreign currency. You're moving manufacturing and sourcing it back to the US. That's been clear. The red tape doesn't get any better, right? The US transition isn't getting better. So how you're thinking today about what your ambitions in terms of redomestication and reshoring to the US. How does the transition influence your decision making?

A - James M. Loree {BIO 1939736 <GO>}

Yeah, it's an interesting dynamic, because on one hand what we thought we would like -- we would do over two to three years, we'd like to do it faster. But the problem in doing it faster is that the ability for people to travel in particular to do the kinds of project management is a little more difficult when you're moving a plant than it is for most other functions that we can do remotely. So we're trying to figure out how to overcome those challenges. We're not going to put a bunch of people on planes and fly them around, while we're in the peak of this pandemic.

So we'd like to move faster. It may not be possible, but in a two- to three-year timeframe, we will bring the China supply chain downsize -- we will downsize it by about 60%. And we're also going to make a pretty big foray into e-commerce in China with a very substantial partner over there. And we're hoping that some of the capacity that we vacate in China in connection with these moves, we're hoping that we can actually redeploy some of that capacity to serve the domestic China market.

Q - Nigel Coe {BIO 3818998 <GO>}

Okay. And so I think today we're mid-40s in terms of US to US. Where do you see that progressing over the next two or three years?

A - James M. Loree {BIO 1939736 <GO>}

Well, over the next two to three years, for North America, which would be about 50% today, we would expect to be closer to 70%.

Q - Nigel Coe {BIO 3818998 <GO>}

Okay, great. I think we've got one question from the audience. Reminder we have time for one or two more. So Jim, what are you one, two high priorities post-COVID? Any ideas here on CRAFTSMAN balance sheets, M&A, but what's top of your mind post-COVID?

A - James M. Loree {BIO 1939736 <GO>}

I think it's going to be an absolute bonanza when it comes to what are the growth opportunities going to be for us. We've positioned this company, I think you referred to it earlier, over the last 20 years to be a real leader in the marketplace to have enough diversification. So as opportunities emerge from a crisis like this, we have resources, we have opportunities that we can seize upon. And I think it's going to be really focused, because some people ask question, how can you take $1 billion out of your cost structure and expect to be investing in growth, in the future, and everything. You're probably shortchanging innovation, et cetera. I will tell you, ruthless prioritization is the answer. If you look at what's most important to growth on a go-forward basis and we focus our resources on that, we will be very successful. We put the weight and might of this company behind what we're going to do. And we'll be coming out with four to six growth opportunities that we will take a little bit of the upside that we expect to experience here now based on the improving outlook and invest it in these types of growth opportunities.

I'm very excited about MTD. Things are going extremely well with that. I am also very excited about e-commerce. We've got a great lead there about almost 3x our nearest competitor in terms of relative market share. I expect we'll probably invest quite a bit more in that. We've got a great global network in e-commerce as well we've been working on for several years. And then security is going to have several different opportunities, which I already referred to. So what I get most excited about for the future are these growth areas and making sure that we prioritize in a very ruthless manner, so that we make sure that we make those happen, while we keep the core innovation going.

And there -- I had the opportunity on Monday to review with the tools folks, in particular, the product leaders for all our different categories. And I couldn't be more excited about what they've got coming. They've got new generations of innovation coming that even blow me away in terms of potential. So I think the core is going to be really healthy and then we're going to focus on some of these additional growth opportunities for the future.

Q - Nigel Coe {BIO 3818998 <GO>}

That sounds very exciting. So the four to six top change you referenced, would MTD and e-commerce be within that category or are these on top of those two areas?

A - James M. Loree {BIO 1939736 <GO>}

They'd be within the category. There is only so much we can do, and I think four to six is the right number.

Q - Nigel Coe {BIO 3818998 <GO>}

Yeah.

A - James M. Loree {BIO 1939736 <GO>}

So they would be like one and two of the four to six. And then we -- some of those in security would be there, and then there's probably at least one in industrial that I think would be pretty exciting, too, that we're still working on refining.

Q - Nigel Coe {BIO 3818998 <GO>}

Yeah. Anything of the scale of a FLEXVOLT in the hopper, maybe not in the next year or so, that you see that kind of breakthrough innovation potential?

A - James M. Loree {BIO 1939736 <GO>}

I'm sorry, Nigel, I didn't catch the first part of the question.

Q - Nigel Coe {BIO 3818998 <GO>}

Yeah. FLEXVOLT, so anything of the scale of a FLEXVOLT kind of innovation?

A - James M. Loree {BIO 1939736 <GO>}

Yeah, I mean I think there is going to be some innovation coming down the pike in probably '21-'22 timeframe with FLEXVOLT.

Q - Nigel Coe {BIO 3818998 <GO>}

Okay, great. And then -- we're getting to the last few minutes here -- I did want to touch on margin resiliency. You put out that $3 million to $5 million kind of benefit from the range of programs within that bucket. I was curious how that's progressing over the past year or so in terms of what you've achieved and kind of like how the path looks going forward.

A - James M. Loree {BIO 1939736 <GO>}

Yeah, I mean we had a year and a half or so headstart on margin resiliency before things started to hitting the fan here in February. And I think that prepared us very well for protecting some of this $1 billion cost takeout, because a good portion of the comp and benefit in particular would have a tendency to snap back as the volume came back. And so we would like the $1 billion to be as permanent as possible.

I think what happens with the $300 million to $500 million of margin resiliency is right now it's kind of mixed in with a $1 billion because it's -- we haven't had time to kind of parse through all the details and try to figure out what is and isn't margin resiliency in this $1 billion quite yet. But a lot of the margin resiliency is applying technology to taking cost out. And that will make it more structurally sustainable. And so therefore, I think some of the actions that would have a tendency to snap back might be offset by some of the margin resiliency. And we've got our eye on the $1 billion number. We'd like to protect that to the extent we can regardless of the volume scenario. We have the opportunity to add some of that back if we get a real positive volume surge in the future, but it's going really well. The margin resiliency program is going very well. And I'm confident we'll execute on that

Q - Nigel Coe {BIO 3818998 <GO>}

And then just one final quick one before we draw the line. You've had a massive headwind from commodity inflation for the past three years. I don't know what the number is, I've got in my model, but it's several hundred million dollars. Is there any reason why we shouldn't get that back in the next several years?

A - James M. Loree {BIO 1939736 <GO>}

Are you talking about inflation?

Q - Nigel Coe {BIO 3818998 <GO>}

Yeah. Commodity inflation, yes.

A - James M. Loree {BIO 1939736 <GO>}

Yeah, okay. So between tariffs, commodity inflation, FX, it's been an enormous, enormous headwind over the last 2.5 years, three years really. And so we're getting it back. We're getting it back, because we are working on restructuring the supply chain. That's going to get a lot of it back in the tariffs and then margin resiliency has a lot of pricing elements to it, and I think you'll see positive price despite the modest deflation that we're experiencing because we're getting a lot smarter about pricing through technology.

And yeah, I mean I think we'll get some of it back for sure, but I don't know how much of it and when, but I do know that right now we're more focused on here's where we are today and here's where we're going on a go-forward basis.

Q - Nigel Coe {BIO 3818998 <GO>}

All right, Jim. I think that's a great place to stop. Thank you very much for your time.

A - James M. Loree {BIO 1939736 <GO>}

Hey, Nigel, great to see you.

Q - Nigel Coe {BIO 3818998 <GO>}

(inaudible) next several months. Thank you very much.

A - James M. Loree {BIO 1939736 <GO>}

Thank you. You too. Take care.