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SWK - Q2 2012 Stanley Black & Decker, Inc. Earnings Conference Call

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OVERVIEW:

SWK announced 2Q12 revenues of \$2.8b and GAAP EPS of \$0.92. Management revised its 2012 EPS guidance downward to \$5.40-5.65.



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PRESENTATION

Operator

Welcome to the Q2 2012 Stanley Black & Decker Inc. earnings conference call. My name is Sandra and I will be your operator for today's call. At this time, all participants are in a listen-only mode. (Operator Instructions). Please note that this conference is being recorded.

I will now turn the call over to Vice President of Investor Relations, Kate Vanek. Ms. Vanek, you may begin.

Kate Vanek - *Stanley Black & Decker, Inc. - VP of IR*

Thank you so much, Sandra, and good morning, everybody. Thank you for joining us this morning for the Stanley Black & Decker second-quarter 2012 conference call. On the call in addition to myself is John Lundgren, President and CEO; Jim Loree, Executive Vice President and COO; Don Allan, Senior Vice President and CFO; and Jeff Ansell, Senior Vice President and Group Executive of CDIY.



Our earnings release, which was issued this morning, and a supplemental presentation which we will refer to during the call are available on the IR portion of our website as well as our iPhone and iPad apps. A replay of the call will be available beginning at 2 p.m. today. The replay number and access code are in our press release.

This morning John, Jim, Don, and Jeff will review Stanley's 2012 second-quarter results and various other topical matters followed by a Q&A session. We encourage you to make one question. You can have one follow-up after that. As always please feel free to contact me with any follow-up questions that you have after today's call.

And as I normally have to do, we will be making some forward-looking statements during the call. Such statements are based on assumptions of future events that may not prove to be accurate and as such involve risk and uncertainty. It's therefore possible that actual results may differ materially from any forward-looking statements that we might make today. We direct you to the cautionary statements in the 8-K that we filed with our press release and in our most recent 34 Act.

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

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

Thanks, Kate, and thank you for being with us this morning. For those of you who have been able to read this morning's press release, I suspect you will have concluded that the strength in our CDiy business as well as continued success with our primarily Black & Decker and Nisayah integrations have helped to mute some of the economic and currency headwinds in the second quarter that had a somewhat greater effect on our industrial and security platforms. So much more detail to come.

Revenues were up 8%, \$2.8 billion. Importantly organic growth up 2%, strong performance in CDiy up 5% organically with an operating margin rate ex M&A charges and payments of 15.7%. The industrial and security segments were pressured by certain weak vertical markets as well as by their presence in Europe. You will hear more detail on all three segments in just a few minutes, so I won't spend more time on that in the overview.

2Q diluted EPS, \$1.32 again ex charges, \$0.92 on a GAAP basis. Some continued positive news and strong momentum on the Black & Decker integration which we now expect to yield an incremental \$50 million in cost synergies next year, 2013. That will bring the total to \$500 million since our March 2010 commitment and closing as a combined company and that's up from an original estimate of \$350 million.

We're not going to spend a lot of time on the synergies and the increment on this morning's call. I'm happy to discuss that, as is Kate off-line. But the two primary drivers of the \$50 million incremental savings were our global strategic sourcing organization continues to gain traction across a larger base and seeing some nice savings there. Some of the programs as we said earlier, our major footprint initiatives that required factory moves, distribution center closures that were more complex, and as a consequence filled with us with more inherent risk. They have gone extremely well, particularly in Europe. So the combination of those two things have given us the confidence to up that estimate by \$50 million and it's something we are very proud of and I am very proud of the team and the many people involved in executing those changes.

Revenue synergies continue to be important. FatMax power tools, you'll hear a little bit from Jeff and Jim; DEWALT hand tools. Those are those initiatives driving growth around the globe.

The Nisayah integration also remains on track. Our pro forma convergent security margin in Europe is up 270 basis points year on year and that continues to move towards the line average but still with a great deal of room for improvement, but right on track from what we assumed and communicated upon closing that deal last September.

We also have increased our dividend by 20%. That's the 45th consecutive annual dividend increase for our Company and that will bring the yield to about 3.3% based on yesterday's closing price. During the quarter, we also completed a \$200 million share repurchase program and the Board has approved -- our Board has very recently approved a 20 million share or about a \$1.2 billion share buyback program. So those are the highlights from the longer than normal release we put out this morning?



Let's move into the business and the 2Q and how it performed. First of all in sources of growth, overall we had our 2% organic growth was 1% from volume of the puts and calls that I discussed, more details later. And we got 1% in price. 10% from acquisitions offset by minus 4% from foreign currency. Virtually every currency that is important to us, the euro, the GB Pound, Brazilian real, Australian dollar, all went or continue to go in the wrong direction and it is having some headwind that Don has factored into the outlook that he will talk about later on in this morning's call.

Some great stories within the businesses. Professional power tools up 9%. Consumer power tools, which includes our outdoor business, which in fact was helped by the weather, up 9%. Lots of puts and calls within industrial, globally the 1% but you had our engineered fastening business showing double-digit growth, offset by some mid to high double-digit declines in some of our other industrial platforms that Jim will talk about in the segment detail.

Hand tools and fasteners essentially flat; convergent security including Niscayah down 3%; MAS commercial 4%. Other security was a combination of access, MAS residential, healthcare, a lot of small moving parts down 5% off a low base. So some very good stories particularly in CDIY and a very nice performance in our engineered fastener business around the globe.

Looking at our geographies on the next slide, I will take them from largest to smallest in terms of their representation of our revenue. So middle left, US essentially a microcosm of our entire Company up 1%, continues to represent slightly more than half of our revenue.

Moving across the page, Europe in total down 2%. We could argue that's a victory or a very strong performance. If you think about the pieces, Europe CDIY -- and Jeff will talk about it -- up 2%. One of the best volume quarters or the best volume quarter since the third quarter of 2010. IAR, security down slightly, Niscayah down 5% as pretty much as we had predicted. So a relatively strong performance in Europe given the headwinds that that geography is facing.

Bottom left looking at Latin America, continued strong growth across most platforms, organically up 7%. Canada, important business for us and very strong performance, up 10% with professional power tools and the lithium-ion platform, the DEWALT and Bostitch hand tools as well as our outdoor business all performing quite well during the quarter.

Over to the right side of the page very quickly, emerging markets in Asia or our emerging markets group as we define it, a small percentage of our Company, only 3% but continued steady, solid growth up 9%.

Japan looks terrific, plus 31%. Remember that's off a very low base of the tsunami-impacted Emhart business this time last year but nonetheless, extraordinary recovery for our engineered fastening business, which represents the overwhelming majority of our business in Japan.

Last but not least, Australia was down 9%. It only represents 2% of our revenue. Hand tools holding up pretty well, our Sidchrome professional mechanics tools business faced some pricing pressure and it's one of the last geographies where we have completed or are in the process of completing our technology shift from nickel cadmium to lithium-ion. So relatively late conversion. That's by design based on product availability. We see that turning around in the very near future.

Normally Jim Loree would take us through all three segments but as I suggested earlier and Kate mentioned, CDIY had an exceptionally strong quarter and today we have asked Jeff Ansell, who is our senior Vice President and Group Executive responsible for CDIY, which represents about half of our revenue on a global basis to be with us on the call.

And Jeff, over to you for some highlights of CDIY in the quarter.

Jeff Ansell - Stanley Black & Decker, Inc. - SVP and Group Executive of CDIY

Think you, John. As John indicated on page 7, strong performance within the CDIY segment during Q2, driven by revenue growth and profit expansion.



Some of the key points to make during the quarter starting with revenue growth total of 5% for the segment, 6% excluding Pfister, fueled as you could see in the upper left by power tools performance.

Across the regions, North America delivered high single-digit growth across both retail and industrial construction or IC channels driven by power tools outdoor products. Hand tools also had a very good quarter but a difficult comp as compared to the prior year DEWALT hand tool load ins that occurred this time last year.

EMEA, 2% volume driven by both hand and power tool expansion with particular strength in the UK, Middle East Africa, and the Nordics, more than offsetting pressures in Italy and Spain, et cetera. Even with the known pressures across EMEA, we delivered our best volume quarter in that region since Q3 2010, as John indicated.

So North America and EMEA both positively comped the prior year load-ins from the 18/20 volt lithium-ion loads that occurred this time last year, so quite good progress.

Latin America continued positive performance with strength in Colombia, Ecuador, Venezuela, more than offsetting pressures in places like Brazil and Argentina.

Our emerging markets numbers in total were positive, consistent with the recent track record. I think the piece that gives us more pride than anything and probably reason for confidence going forward is that we had volume growth in every region of the world excluding Australia and New Zealand, which is both small and improving, as John indicated.

That revenue growth around the world also enabled at least partially enabled OM expansion of 140 basis points. Again the combination of volume leverage, efficient promotional planning, and cost synergy attainment concurrently all enabled that performance.

If you turn to page 8, perhaps a little deeper dive into the numbers from a quarter and a merger to date perspective. Starting in the upper left box, point-of-sale and average annual growth rates, we've spent a good deal of time talking about POS performance over time and repeatedly made the point that volumes and POS may not be consistent in a given month or quarter but over time they certainly counter balance one another. We have attempted to depict that clearly for you all hear that if you look at the three-quarter performance, Q4 of 2011 through the first half of 2012, volumes were plus 5, POS plus 4 with inventories in relative balance.

If you dissect that a little further on a year-to-date basis, volumes up 5, POS up 5 in perfect harmony. Since integration, the CDIY POS has grown an average mid single digits with the DEWALT business in total more than 2x that rate.

And then finally, the CDIY average annual growth rate as compared to our key US customers' comp store performance, so our US value versus key US retailer comp performance, CDIY is plus 3.5% versus the average of the major customers at about 2.5%. The point to make would be clearly we feel like we are gaining share but also our growth fuels our customers' growth and their growth clearly fuels our growth.

Turning to the upper right quadrant in terms of market share, coming into this integration, we held the market-leading market share position globally. We've since added about 200 basis points of share over 2010 and 2011 and obviously those numbers are only reported annually. Both years representing share gain.

A point of note is in the second bullet and that is around DEWALT cordless. Over the timeframe of the integration, the DEWALT cordless business has grown at 50% faster rate than global cordless in total to the highest level in history. We have never had a larger cordless business than we have today.

Since the integration, our NiCad business, our legacy platform, has remained flat while lithium-ion has grown 5x to commensurate size and profitability, giving us strength in the market.



Turning to the bottom left box in terms of profitability, CDIY has added about 600 basis points of profit improvement over the period of the integration. Record profitability has been driven from new product development, accessory growth, efficiency and enhancements in our SFS process, and gains in emerging markets. Profitability has improved on both an organic and a with and without synergy number so in total, both numbers improving over the period of time.

Then finally, the enabler of all these things really around new product development and revenue synergies. Some key elements to note, DEWALT and Bostitch hand tools augmenting the strength of our Stanley hand tool business has enabled share gain and in fact over the course of the integration, the hand tool business has grown, which was a key deliverable for this organization.

We have launched FatMax power tools to augment the strengths that we have in the Black & Decker and DEWALT brands around the globe. That began in the first quarter of 2012 and will continue globally through the end of this year and beyond, but initially very good response.

Emerging markets have been pervasive in their expansion improving our hand tool business, our power tool business, and our power tool accessory business concurrently.

Then finally during the quarter the latter part of Q2, we acquired Powers Fasteners. Powers Fasteners was founded in 1921 and is a leader in [code] approvals globally. They play in a \$3.8 billion market and they are roughly a \$140 million company with strength in the US and Australia and New Zealand. This creates the only concrete tool, fastener and accessory portfolio within the US fastener business. Powers also provides the opportunity to pull through such existing products as DEWALT hammers, accessories, and pneumatics while at the same time Stanley Black & Decker provide the opportunity to expand the Powers portfolio into markets where we have an established commercial position. Initial integration results are positive. Initial customer feedback is quite positive.

With that said, I will turn the floor over to Jim to report out on the other segments.

Jim Loree - Stanley Black & Decker, Inc. - EVP and COO

Thank you, Jeff, and kudos to your team under your leadership, which really did a remarkable job simultaneously integrating these businesses from Black & Decker and from Stanley, each of which when combined is -- this unit is larger than either of the two companies in totality before they were merged. So a \$5 billion plus business, a lot of moving parts, global, a lot of issues to deal with on the NPI front and somehow the execution in delivering this was just phenomenal and I think it's a credit to you. I'm glad you are on the call to be able to describe that and answer some questions as we go forward here.

Let's move on to security. Security revenues were \$792 million, up -- up 29% versus a year ago when there were \$613 million. Segment profit was \$122 million, up 15%. The proper rate was 18% which was very impressive excluding acquisitions, i.e. Niscayah in particular and 15% including acquisitions. The 18% represents a 240 basis points sequential improvement and the 15.3% would be a 200 basis point sequential increase.

The profit rate improvement was accomplished despite weakness in core markets and negative 4% organic growth. As you look at the organic growth, you can see that CSS was down 3%. They had a flattish US performance. Europe was down in mid single digits not surprisingly and that would be the legacy European piece of our business, which was primarily focused in France.

And then the commercial MAS, which includes access and the SMS business, or commercial mechanical security, was down 4%. Access continued to have issues with the CapEx requirements of its major customer which were significantly decreased from a year ago. That will anniversary here shortly and not continue to be a problem.

And then the SMS business had some issues with respect to a sluggish US retrofit market in particular, healthcare, government and education, all those institutions facing budgetary issues as well as a continuing gap in their product line, the MPP product line which as the economic issues have continued over the past few years, the products in the market have -- the buying preferences have shifted more to an MPP product, a mid price point product. And we were a little bit slow to design an MPP and introduce an MPP line.

The Tong Lung acquisition, which we initiated a tender offer earlier this year, is critical towards resolving this issue and we will close that, the majority of the shares here in the next few weeks and then get right to work. We're already actually working on the MPP line for the commercial business through Tong Lung.

And I would also say that Tong Lung is the world's lowest cost manufacturer of locks, of quality locks in the world. They have plants in the Philippines and Taiwan and this is a highly strategic acquisition and places a new advantage here for us in terms of cost competitiveness on subcomponents in the HPP line for commercial security and also fixes -- will help us fix this product gap and obviously makes the HHI transaction more palatable too from a divestiture standpoint.

Moving on to other security, that was also down about 5%. That included the residential business and also the healthcare. Resi was down in low single digits as the market kind of slowed from the first quarter strength it had enjoyed. In healthcare, the Obamacare Supreme Court decision weighed heavily on CapEx decisions that were made by acute-care and secondary care providers, so that was a very, very weak market in healthcare. And so a little bit of an issue there.

And then we also you will note acquired a company called AeroScout in the quarter, which is a highly, highly strategic acquisition not only in security but throughout our portfolio and I'll talk about that in a minute. But they are the number one player in the RTLS market in US healthcare, actually global healthcare. RTLS being real-time locating systems or active RFID systems which enable patient tracking, temperature sensing, asset tracking, all on WiFi networks and this capability will allow us to really provide a value proposition to our customers that goes beyond anything that we have seen before in our healthcare business. And I will talk more about that in a few minutes.

Moving onto industrial, our industrial revenues were \$635 million, up from \$626 million a year ago, a 1% increase. The organic growth was 1%. There were 4 points of negative currency offsetting 4 points of inorganic growth. Segment profit was \$95 million, down nominally from \$97 million a year ago. The profit rate was off 40 basis points, came in at 15.1% but was in the normal historical range for industrial despite a double-digit contraction in IAR Europe, where the contribution margins are near 50%.

So you will recall the last few quarters the industrial business has been increasingly profitable in terms of rate. It was in the 18% range last quarter and so it's down from there but it's almost all driven by cost absorption issues in the Industrial & Automotive Repair European business, which as I said, has very rich margins.

The European business was down in double digits for IAR. We had high single digit organic growth for our North American and mobile distribution business and a very strong OM performance as well. That's a code word for Mac Tools, by the way. Our Proto business was pressured and was negative in terms of organic growth by weak government sales in particular the industrial markets through the MRO held up reasonably well.

And we'll talk again in a few minutes about the acquisition of AeroScout, which is going to enable our industrial business to create a new business unit for advanced industrial solutions, which will take RFID and RTLS technology to our industrial customers through the IAR business.

Engineered fastening, John mentioned, had a great quarter, 10th consecutive quarter of double-digit growth despite a situation in Europe with an 11% decline in auto production in Europe. So a terrific job by those folks. Japan did benefit. We have a reasonably large business in Japan that did benefit from the tsunami recovery production. That was helpful but in general these folks are making terrific progress on vehicle penetration and managing the business very tightly. So they were a real success story in the industrial segment in the quarter.

Hydraulics and CRC-Evans, which make up the infrastructure business, in particular were actually both pressured from a volume standpoint, CRC had organic revenues down 10%, all driven by actually more than -- a bigger decline in the North American onshore market which we have discussed previously on calls mainly due to the diminished US pipeline market for gas and oil and that is an ongoing saga. But they have made great progress on the offshore business offsetting a lot of that decline. So we are in a cyclical trough right now in North America onshore.

Offshore is growing by leaps and bounds I think when the onshore comes back, and it will, this will be a big growth driver for us. So industrial produced a respectable quarter under mostly difficult market conditions.



Now in the press release, we discussed a tactical change as it relates to acquisitions and a few folks before the call mentioned -- when they called in mentioned that they thought this was a strategic shift and I will very clearly say that this is not a strategic shift. It is merely a tactical move to digest what we have acquired in the last few years and to take what we have acquired and to rev up the organic growth engine, which is essentially another form of integrating these acquisitions. And we don't just buy assets and let them sit kind of by themselves. We take them -- when we buy them we generally buy them because they strengthen our value propositions and sometimes it takes a little time and focus to make sure that we get that right and make the moves to drive organic growth.

So what we have done over the last few years in terms of Black & Decker, Niscayah, GMT, CribMaster, AeroScout, Tong Lung, and CRC-Evans and now Powers as well, all of these are going to provide a strong catalyst for organic growth. So over the next 12 to 18 months while we focus on organic growth, which I think is timely given the difficult markets in some of our businesses, we have got five major growth initiatives which we are pursuing which have collectively the capacity to drive two to three incremental points of organic growth over the next few years each year.

So let's start with emerging markets. I think many companies are putting some focus on emerging markets. We've been doing that for a long time. I think the Black & Decker merger helped us drive scale in this area. We've gotten to a point now where the basic integrations are complete in the emerging markets. We are benefiting from that but now we are going to rev it up a notch and we are going to create new Asian-based dedicated SBUs for mid price point hand tools, power tools, and commercial hardware products.

Why is this important? Because about 70% of the market in emerging markets is in the MPP range and in the past most of the high price point power tool players and hand tool players have really come at it from taking those types of products and trying to modify them to some extent and then sell them into the MPP and HPP segments of the market in the emerging markets.

That is a strategy that only has so much potential and in order to fully capture the opportunity, we feel that it's important that we create these Asian-based SBUs which are going to design and provide products to all our emerging markets around the world. And so this is a big sea-change for us and I think one that is going to lead to significant market share gain.

Obviously there will be plants in production that follows as we continue to gain market share.

The commercial hardware SBU will leverage the combined capability of GMT, which was that China-based commercial hardware acquisition that we made about a year and a half ago. And we will combine that with Tong Lung, Tong Lung's capability and we will be able to design a full range of MPP products in the [EN] or European standard and also design products that are cost-competitive in the American Standard. So we will have all the products that we need to drive share gain in commercial hardware around the world, leveraging our network.

We will also make significant feet on the street additions in the emerging markets for local product management, local marketing, and local sales teams. We obviously have some of that already but we are talking about ramping up that resource significantly. Combined all those activities should generate at least \$300 million a year of additional revenue by year three.

Secondly, the smart tools and storage for IAR; this is the leveraging of CribMaster and the AeroScout Technologies into the industrial markets including areas such as MRP vending, FOD Control, which is foreign object damage, which is critical in aerospace markets, Electronic Kanbans, and plant productivity monitoring. This technology that we have with CribMaster and AeroScout, enables all of this and just yesterday we formed a new SBU under JoAnna Sohovich and IAR which will take our capabilities here and form a salesforce to take these products to market in a bigger and more aggressive way than we have in the past.

Some of these abilities are brand-new for us. We've had great success already with CribMaster. Since the acquisition, we have just recently logged about \$60 million in new business about half of that in the US, half in Europe. And this is all in the MRP vending so we're well on our way towards achieving this \$100 million goal by year three. I think we should definitely exceed that as we go.

Then there is offshore oil and gas pipeline services. This is about a \$0.5 billion market opportunity. We've made great progress here already. What we do now is we provide bundled solutions to spoolbase owners for services such as staging the pipes, joining the pipes, welding them, coating



them, inspecting them, and loading them on the ship. These spoolbases today are operating at about 30% capacity. The expectation is over the next year or two that will increase to about 60% to 70%. We have already won the business so now we just have to enjoy the growth there.

And then right now we're working on a new concept which is to provide these folks with automated portable spoolbases so that we can move them around the world as their needs change and as the -- as new sources of energy are discovered. So this should easily be an incremental \$100 million of growth potential by year three.

And then a final one excluding Black & Decker is the RTLS-enabled security and this is simply taking the AeroScout RTLS capability and leveraging it into the electronic security market. The biggest thrust here will be into healthcare in the acute care facility vertical and we are forming an internal sales JV between CSS and our healthcare business. We will have about 30 to 40 reps covering the C-level executives in these institutions and they will perform consultative assessments of safety, security, efficiency, and compliance. And then they will offer the solutions to solve the problems that are discovered during those assessments.

This concept plays right into the sweet spot of what these types of institutions need right now, which is to maximize their reimbursement and to achieve significant cost savings.

Then finally, we have these Black & Decker revenue synergies that have been so successful so far. We have already driven about \$250 million of benefit from that. We fully expect to deliver on our \$300 million to \$400 million external commitment and hopefully over the next year or two get to the high end of that range and perhaps drive beyond it. So as I said, these five initiatives when taken in the aggregate have the capacity to drive 2 to 3 points of organic growth over the next few years. Very exciting.

And so taking a 12- to 18-month break from acquisitions to enable us to do this I think is probably a pretty good idea.

Okay, let's move to working capital. SFS continues to be a great value creating story with a 1 turn improvements, 7.1 turns and with an 8% increase in total sales and a 15% reduction in working capital we achieved on a year-over-year basis to \$1.445 billion. Just to put it in perspective, as a refresher in second quarter of 2009, our pro forma working capital was \$2.1 billion and we were at 3.9 turns.

In the postmerger period, we have eradicated \$700 million of working capital and extracted that and put it to productive use. This has been a phenomenal value-creating story and we're well on our way to achieving the legacy Stanley peak performance of 8.6 turns. We fully expect to get there sometime in 2013 and we expect further progress as the year goes on here.

Now I will turn it over to Don Allan, who will take you through some of the financial aspects.

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

All right. Thank you, Jim. On page 13, as many of you read in the press release this morning, we talked quite a bit about portfolio transformation and capital allocation. And before I get into the details on this page, I just want to remind everyone if you go back to our strategic framework that's been in place since 2004 timeframe, the first tenet there is really about portfolio transformation. And it discusses mixing into higher growth and higher profitability businesses over the long-term as well as increasing our weighting in emerging markets and specifically having a goal of getting to 20% of the total company in emerging markets by the middle of this decade.

The net result of that as we drive towards the long-term and as we grow will be continued diversification away from US home centers, i.e. as we grow in our growth platform, that will become a smaller part of our company.

So what we decided to announce just to give people an update of where we were in our continued portfolio transformation and we are in the process of evaluating the potential divestiture of our hardware and home improvement business.

Just as a reminder for those of you may not be as familiar with that business, it is approximately \$940 million in revenues. It operates largely under the brands Kwikset, Baldwin, Weiser, Stanley, National, and Pfister brands. It is not a CDIY business aside from the Pfister business. We do include the Pfister business in our CDIY segment. The remainder of the business is included in our security segment.

90% of the revenues are North American-based and more than 50% of the revenue is through US home centers. We think it's a very healthy business. It's had operating margin rate performance in the mid to high teens over the last few years. It is constrained into North America primarily, as I mentioned 90%. It does have long-term growth prospects; however we do think we could potentially reallocate our capital into other areas that are higher growth in different industries. And it certainly has a very heavy weighted concentration in US home centers.

For those of you who asked the question why would you want to sell a business potentially that is at the bottom of the housing market today? Well, I just remind everybody is we do have a business, CDIY, that's over \$5 billion in revenue which has world-class brands, market-leading positions, and that certainly provides us to quite a significant potential upside to a housing recovery. As we have told many of you before, we think when you look at the peak revenues of that business in the past to where we are today, there is a potential \$1.5 billion of revenue upside in any type of housing recovery of significant magnitude and that I would assume getting back to a level of 2 million housing starts which maybe we will never get back to that but certainly there's a great deal of upside opportunity just in that business.

If we make the decision to sell the HHI business, we do think that the after-tax proceeds will significantly exceed \$1 billion.

We are also in the process of evaluating a highly accretive and very strategic asset in our engineered fastening business. It's approximately \$500 million in revenue. It's very synergistic with our current engineered fastening business. It's in favorable growth industries so has that high-growth attribute that we are looking for, very strong concentration in emerging markets where the revenue is -- greater than 50% of the revenue is in emerging markets.

And like any particular asset that we evaluate for acquisition, we will go through the process of evaluating whether it will achieve certain accretion profiles as well as other return thresholds that we try to maintain throughout our entire requisition process. We will only proceed if we are able to achieve those aspects. But clearly a very compelling strategic asset that's under consideration for us.

The other area that we're looking at for capital allocation is the potential of doing a share repurchase in the future. Certainly looking at our current stock price yesterday closing below \$60 is a nice investment for us to consider as part of this capital allocation or reallocation strategy.

So given all that, there are two likely scenarios that I think could play out here. One is the potential sale of our HHI business and utilizing those proceeds to invest in this engineered fastening asset I described. And on top of that if there's excess cash available, utilize that to do share repurchase.

The second likely scenario that we sell the HHI business but decide not to acquire the engineered fastening asset and utilize those proceeds to buy back stock after we do some modest deleveraging in that scenario as we will lose approximately \$200 million of EBITDA when we sell that business.

Neither of those two scenarios will result in any significant annualized EPS dilution. It's very important that people recognize that.

The third scenario which I think is less likely would be that we decide not to sell the HHI business; however, we do acquire the engineered fastening asset for the reasons that I articulated. Again, I think that scenario is less likely than the first two but it is something that we will consider in this process.

The end result of any of those scenarios will be that we will be taking 12 to 18 months off from business development aside from some small emerging market activity, as Jim mentioned. And also as Jim mentioned, that is not a strategic shift. It's simply a break and really looking at how we need to continue to integrate the acquisitions that we have done and Jim really walked through the details of where we are focusing that effort primarily on organic growth.

Moving to page 14 and a look at guidance for the year. So we've lowered our guidance to \$5.40 to \$5.65 from the previous guidance range of \$5.75 to \$6.00. Let me walk through some of the assumptions associated with that.



We are reiterating our organic net sales guidance for the year. We do think the pro forma net sales will continue to be 1% to 2% year-over-year so that includes the effect of Niscayah and a full year for 2011 numbers when I say pro forma.

When we look at regionally, we think the performance will still be consistent with North America up 1%, Europe down 3%, and emerging markets between 10% to 15%. You can see year to date North America and emerging markets are pretty aligned with that assumption.

Europe is a little different. Europe is not quite as bad as that 3%, as John and Jim have both articulated previously in the call. We do expect that things will likely continue to deteriorate in Europe so we are sticking with that negative 3% in that region of the world for the year.

We expect our BDK cost synergies to be \$115 million this year and \$45 million for Niscayah so no change there. And then the cost reduction actions which are really targeted at discretionary spend back in the first quarter of \$150 million, that's in place and we anticipate that that will be achieved. Our share count will be roughly \$167 million.

We believe our free cash flow will be \$1.2 billion so no change with that. It does assume an increase for benefits from working capital. Jim talked about where we stood to six months at 7.1 turns so progressing very nicely in that area.

And just reminder for those of you who may not be as familiar with our Company, there's a great deal of seasonality associated with free cash flow and if you look at our history, the two combined companies, the first-half history as a percentage of the full year tends to represent anywhere from 21% to 24% of the total year. And if you look at our \$300 million performance through the first half, that clearly would indicate a path to \$1.2 billion performance for the year.

What we're changing to the right of the page or updating associated with our guidance is we continue to see incremental headwinds from foreign exchange, an additional \$55 impact to our operating margin. And then you can see in the interest and other line, we have an additional \$20 million negative impact as well. That is \$75 million of incremental negatives associated with foreign exchange or \$0.35.

If you look at the currencies associated with that and I will just take people back to our January earnings call, I walked through a fair amount of detail around foreign exchange. And there's really three currencies as John touched on at the beginning, that have a significant impact on our business. They represent about three-quarters of our international exposure. That's the euro, the Brazilian real and Canadian dollar.

Back in January, I pointed out that going into the year we thought FX would be a negative of \$0.45 and it's really being driven by the fact that the euro has been down 7% going into the year. The Brazilian real down 11% and the Canadian dollar down 3%.

What has happened since then? Well, I think we all know that they continue to deteriorate and as of the end of the second quarter, the euro is down an additional 5.5% from that \$1.29 rate it was at at the end of last year down to closer to \$1.22 now.

The Brazilian real which was at about \$0.535 at the end of last year going into this year is now down to \$0.48 at the end of the second quarter, so down 10%, an additional 10%. The Canadian dollar, \$0.98 at the beginning of the year, now down to \$0.965 at the end of the second quarter, close to 2% decline. So you can see we have seen significant declines, very similar to declines as we went into the beginning of this year, which is contributing to another \$0.35 negative drain on our EPS performance. That's a total of \$0.80 year-over-year negative due to foreign exchange.

Hopefully that's helpful providing that level of information.

The other area that we are seeing a negative against our earnings is a negative mix impact as although our total revenues are not changing for guidance, we are seeing a shift to our CDIIY business is performing very nicely as you've heard but we are seeing pressures in our Industrial and Security segments that Jim articulated on. That is causing a \$50 million negative on the year for our performance this year.

Embedded in there is a slight improvement in commodity inflation so we are seeing modest improvements in that area. That is embedded in the \$50 million negative.

What we decided to do is we want to quickly take action as we tend to do as a management team is really focus on what we can do to offset some of those market economic and operational pressures so we decided to take an incremental \$50 million of cost actions in the second half of 2012, largely headcount-related actions. That's \$100 million of annualized cost take-out so clearly there's a carryover effect into 2013. That's really to try to offset the impact of this negative mix I just described.

We also had a few acquisitions in the second quarter as discussed previously with Powers Fasteners and AeroScout. We don't expect that to have an impact on 2012. However, as we move into 2013, we do think that will have an accretive impact of approximately \$0.10 in EPS. So as we begin to integrate and drive on some of those synergies that were discussed, we will start to see that positive accretive impact on that investment we made.

One last housekeeping item, tax rate is still expected to be between 22% and 23% for the year. However, we will see a little bit of volatility between the third quarter and the fourth quarter with the third quarter likely being mid to high 20s and the fourth quarter being below 20% due to some timing of certain tax contingencies.

So the take away from this is that we clearly had a certificate negative mix offset. Our volumes are consistent overall for the Company. We're taking incremental cost actions to offset that mix impact. And we've lowered our guidance due to the foreign-exchange pressure only.

So a little more in-depth discussion here on page 15 associated with the three segments. We continue to drive margin rate expansion across the vast majority of our businesses in 2012 as well as the whole Company. We're being very proactive about cost containment and driving successful integration in a low organic growth environment today.

For CDIIY, we believe we will be mid single-digit organic revenue growth for 2012. We have not assumed any large housing rebounds. We do expect market share gains to continue with the rollout of new products, the execution of revenue synergies really to drive this growth.

We anticipate the operating margin rate to expand above 2Q 2012 level in the second half due to favorable price inflation trending, based on current commodity costs, cost synergies that we continued to execute on, the cost actions I just described, as well as continued volume leverage.

In the security segment based on the performance through the first half and some of the pressures they are experiencing that Jim described, we expect low single-digit organic revenue declines for the entire year of 2012.

Despite this revenue drag on segment margins due to lower volumes as well as Niscayah continuing to be integrated, the execution of the cost synergies and the cost-containment actions that we've taken on this year as those we have just started to implement for the back half of the year will still result in a flat OM rate performance year-over-year, which would be quite an achievement given some of the volume pressures.

On the industrial side, we do expect to see low single-digit organic revenue growth for the entire year, so nice performance in Q1, up high single digits. Difficult revenue performance in the first quarter but still had -- in the second quarter -- but we still had some growth so we expect modest growth in the back half.

The operating margin rate will likely expand in a modest way or moderate way versus the 2011 level as we continue to take cost actions to mitigate the volume pressures that we have experienced in Q2 and expect in the back half of the year.

We do think there will be nice growth in the engineered fastening business on the revenue line to really moderate some of the pressures we are seeing in the industrial automotive repair sector as well as that onshore pipeline market that's affecting CRC that Jim touched on.

So to summarize the call this morning, we believe we have a very strong track record of navigating through challenging macroeconomic times. We are very focused on what we need to do and how to continue to move forward with our earnings, cash flow, and our portfolio transformation. The negative mix offset -- the negative mix I described as being offset by incremental cost actions but yet, the FX pressure will result in lower annual guidance. So the \$0.35 of incremental FX pressure is the primary driver of reducing our annual guidance.



The Niscayah and the Black & Decker integrations continue to be very successful. John touched on the incremental \$50 million of cost synergies related to Black & Decker that will occur in 2013 so we continue to be encouraged with the net impact and results of that.

We are very pleased to announce the 20% dividend increase as we continue to return capital to our shareholders which has been our track record over the last decade and beyond. We also put in place a 20 million share repurchase authorization to be able to respond to the potential outcomes I described around capital reallocation.

Outside of the HHI-related activity, as both Jim and I have mentioned, we will curtail major bolt-on acquisition activity for only 12 to 18 months and focus on some smaller emerging market acquisition activity as well as focus on these key organic growth initiatives of \$500 million and \$600 million of revenue over the next three years.

The Stanley fulfillment system is really continuing to drive improvement over year-over-year and you can see with working capital up 16%, working capital turns of 16%, 7.1 turns. That results in a \$1.2 billion free cash flow forecast for this year which would be a 20% increase from 2011.

We continue to try to be agile, proactive around our cost containment and focused on our organic growth opportunities given the tough macroeconomic environment.

So that concludes the presentation portion of the call.

Kate Vanek - Stanley Black & Decker, Inc. - VP of IR

Sandra, why don't we turn to Q&A?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mike Wood, Macquarie Capital.

Mike Wood - Macquarie Equities - Analyst

Thanks for taking my question. To get to the relatively flat security margins for fiscal year 2012, it implies a large ramp up in the second half. Can you talk about the timing of specific actions that are hitting in terms of what's driving that expansion around the weak organic growth in the segment?

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

I think it's really two things that are occurring there. Of course the continued execution of the Niscayah integration, as we see more synergies occurring in the back half of the year, and as we go into 2013 as well as a very proactive cost actions they've taken at the beginning of this year as well as the most recent ones we're looking at where \$100 million of an annualized program across the whole Company, certainly security will have a certificate portion of that.

And I guess the last thing I would mention is that they have been very proactive around passing on price to the customers where appropriate given certain inflationary pressures that kind of occurred in the past. We would expect those price increases to stay in place and be able to drive improved margins in the back half.



Mike Wood - *Macquarie Equities - Analyst*

Okay, and within that segment, can you help us understand how that 6% order growth that you reported last quarter impacted 2Q? So were there customer delays in terms of those orders coming -- turning into sales or was there just a substantial weakening in orders in this current quarter?

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

The dynamic that is happening there, you are primarily referring to our CSS, our conversion security solutions business, where we did have a backlog growing into last quarter. And clearly this particular industry is feeling a little bit of pressure around subcontract resources in that space. The subcontractors that are used in this space are used for not only our business but they are used by the cable companies, the telephone companies, etc. and so there is a bit of the resource strain right now in that space that's causing a little bit of drag and then you combine that with some of the restrictions we are experiencing in the government channels as well that is putting a fair amount of pressure on both order trends and what I would say conversion of orders into revenue.

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

This is Jim. The last few years, I think we have been pretty good at getting the orders in CSS and not as good at converting the backlog in a timely fashion. And part of that underlies the leadership change that we made in CSS North America where we now have somebody in place who is a more generalist type of a leader who has got the operations capabilities and focus as well as the sales and marketing.

Operator

Jason Feldman, UBS.

Jason Feldman - *UBS - Analyst*

Good morning. On M&A, you described this pause as a tactical change and I'm sorry I didn't mean to mischaracterize it -- but I guess I am just kind of curious as to why you think this is the right time. I understand that you need to focus on integrating what you have but you seem to have strong confidence in your cash flow. You are possibly selling HHI with sales that are rather depressed and valuations and multiples on potential acquisitions look relatively attractive where they are available. So isn't this actually the time where you'd almost want to do the opposite for now and then come back to the integration and organic growth initiatives going forward sometime in the future?

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

Your observation is very logical but what you are leaving out or missing that I think will be helpful for you and everyone else is we look at three things, all of equal proportion, as we evaluate acquisitions. This hasn't changed since 2004. Specifically, and you are well aware, we look at strategy, the strategic fit. Does it fit with our growth platforms, as Jim very articulately described them? Is it high-growth? Is it where we can compete? Is it where we can have global class leadership? Is it where our brands matter? That's the first screen.

The second screen is the financial hurdle. Does it significantly achieve our cost of capital? We might discriminate in favor of an acquisition where we could use overseas cash because obviously it's earning such a low return. But simply said, if it's a small bolt-on, it has to get to our financial hurdles, 15% operating margin, 15% ROCE quicker than a large one but that's the second if you will filter.

The third is organizational capacity and I think maybe that's the one that you are leaving out in your observation. Specifically, we are as likely to walk away from a deal or not pursue a deal because we don't think we have the corporate or business-specific capacity to aggressively integrate it, manage it. Two things.

A, what comes with the acquisition in terms of management, and B, to the extent management -- we are as comfortable with the management that comes with the acquisition, what exists in house within our various businesses to give us the confidence we can successfully integrate. If you just look very quickly within our segments, our CDIY team is incredibly capable. That being said, they have for 2 1/2 years been integrating Black & Decker. That's been 75% of the activity has been within CDIY.

We have just added Powers, which as Jeff described, is strategic. It's going well. Their plate is very full. Within security, we bought Niscayah. We closed on that deal less than nine months ago. A lot of it is in Europe. Niscayah didn't come with as much operating management as we had anticipated and as a consequence, we have redeployed some of our more capable executives to oversee that business. It's going very well but Brett Bontrager and his very capable team also have a very, very full plate.

That leaves the industrial platform where some of the opportunities are smaller. One of our more capable tested, proven teams with arguably the organizational capacity is industrial in general and our engineered fastening team in particular, which is why Don referenced and Jim did that we are looking at something in that space.

So when you cut through it all, the organizational capacity issue digesting what we have -- making sure that we have properly integrated them, set a solid foundation, and teeing them up for strong organic growth is every bit as important as the other two I will say filters that you I think appropriately pointed out.

Jim Loree - Stanley Black & Decker, Inc. - EVP and COO

I will just add to that that we always look at one other thing which is our capital allocation strategy over the long term which has been to take about two-thirds of our capital, excess capital, and allocate it to acquisitions and the other third to return to the shareholders in the form of dividends and share repurchases. And we tend to favor share repurchases at moments when we think the stock is grossly undervalued. And it's difficult for us to look at Stanley Black & Decker, this world-class series of franchises trading at 6 times EBITDA and then go buy some small private company for a couple hundred million dollars at 9 or 10 times EBITDA and justify why we would want to do that in our heads.

So we are going to work on organic growth, digesting some of these acquisitions for all the reasons John said and we are going to take the excess cash for that period of time and we're going to maintain our credit worthiness and whatever is left over, we are going to buy back our own shares until we get to a point where the arbitrage is more -- is closer and makes more sense.

Jason Feldman - UBS - Analyst

Thank you. That's very helpful. Just lastly, but in terms of the repurchases, the way that I thought I heard Don describe it, the new repurchase authorization seems to be largely a potential redeployment of the HHI proceeds, assuming that that deal happens.

Jim, did you just suggest that basically the two-thirds that normally is used for M&A, of free cash flow is also on the table for potential repurchases?

John Lundgren - Stanley Black & Decker, Inc. - President and CEO

Historically, Jason, the allocation is two-thirds but historically in the last five years, it has been close to 50-50 between buyback and dividends; 45% to 55% of our cash has been returned to shareholders in the last five years despite the -- if you will -- ideal allocation over time that Jim described as basically two thirds, one third.

Jim Loree - Stanley Black & Decker, Inc. - EVP and COO

What that enables if you think back to the long-term financial objectives that we've had in place since 2004 is that we would like to grow our revenue organically about 3% to 4% a year and then we like to grow our total revenue somewhere in the neighborhood of 10% to 12%.

We have far exceeded the total growth rate over the last decade growing closer probably to around 20%. However, that was aided by that one very large acquisition or merger, Black & Decker. I think if you take that away, probably closer to right around the stated goal that we had.

So that particular, there is no real magic to that other than the fact that our capital allocation between 50% and two-thirds of our excess cash flow with the prices that we typically pay for acquisitions enables us to achieve that math. And that math when we grow the top line 10% to 12% a year, our goal is to grow -- to expand margins at the same time and to achieve midteens earnings growth. And we have definitely achieved that over the last decade and that's what we're going to continue to do over the long term.

That's why we use the word tactic to describe this because we do occasionally have a tactical change here where the organizational capacity becomes an issue, where the arbitrage, the valuations become an issue or opportunity maybe to characterize it more positively. And under those circumstances, we typically will shift to a more repurchase kind of focus for a period of time.

That has served us very well. In the early part of the last decade, we bought back several hundred -- probably close to \$600 million worth of shares in the 20s. A couple years ago we bought back another similar amount in the 40s, and so I think we have a pretty good sense as to when the stock is grossly undervalued. And I feel like we are in that kind of a mode right now, so this makes perfect sense, especially given our organizational capacity constraints at the same time.

John Lundgren - Stanley Black & Decker, Inc. - President and CEO

Jason, one final point because you've asked your follow up and you get cut off, as it relates to buybacks also keep in mind where that cash is. At most US multinationals, the majority of our cash is generated overseas. Buybacks with overseas cash obviously are not terribly tax-efficient. So our desire to do that, to do more, is somewhat constrained by where our cash sits.

That being said, there are ways to work, work through that, work around that. And Jim's point is a really important one. We think the best investment out there is SWK at \$60, so the hurdle for an acquisition is higher than it's ever been.

Operator

Dan Oppenheim, Credit Suisse.

Dan Oppenheim - Credit Suisse - Analyst

Thanks very much. I was wondering if you can talk a bit more in terms of the HHI and fastening potential transactions there. You have been talking about the stock. It seems you are very aware of the valuation there and thinking about the repurchase. On HHI it seemed pretty clear in terms of just what you would like to do with that. Wondering if that's a thought that you are being potentially being paid for the (inaudible) growth and as the business rebounds your housing or if it more of a strategic issue in terms of wanting to divest that at the time?

John Lundgren - Stanley Black & Decker, Inc. - President and CEO

The reason now we feel is a good time to divest HHI, because as Don said earlier, HHI has reasonable growth prospects in the next couple years ahead of it in the US and that's largely because we are at a stage in the cycle where we expect some sort of a housing recovery and so do the potential buyers of this asset. That makes it attractive to them.

From our perspective, we using a slightly longer term strategic lens, look at it and say that would be great to ride that. We will get paid for a good part of that. It is a relatively tax-efficient transaction by the way. And our stock is -- to the extent we use the proceeds for repurchase, our stock is undervalued as we've talked about, so that all makes sense to us.



But over the medium term, the strategic attractiveness of that business is okay in terms of growth, as Don pointed out, but it would take an enormous effort and a lot of capital to invest in international and emerging market capabilities, very North American-centric. So there's a short-term ride ahead in North America. To position that business for the long term, the amount of effort that would be required, the amount of capital starts to put it in a position where the other opportunities for faster growth -- with opportunities with more margin expansion potential, with locations in the emerging markets in particular, emphasis on the emerging markets, there are other opportunities that are on our growth platforms that are much more attractive to us.

So the timing is absolutely perfect for us to divest the asset because it will command a very good price. We are pretty confident of that and if it doesn't, by the way, we won't sell it. So I think that's a very logical time to do it and hence the decision.

Dan Oppenheim - *Credit Suisse - Analyst*

Secondly just wondering, I think, John, you've been pretty clear in terms of the thoughts and growth in emerging markets particularly in Asia and sort of growing to the global diversified industrial company. I think when you are talking about ramping the local teams there, do you think that you have enough in terms of your (inaudible) or how much would you expect to see in terms of just very small acquisitions in terms (inaudible) there?

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

Two things. Most of it is going to be organic and Jim touched on this when he described the formation of the new focused SBUs to drive organic growth in emerging markets. I will address both your questions.

Most of those are internal resources but that was one of the luxuries of the Stanley Black & Decker merger, where each company I will say had a desire but honestly not the commitment in terms of management feet on the street, etc. We were both spread rather thinly to be very candid. And while a lot of people came out of the combined organizations, we've talked about this before -- so I won't repeat it, no one came out of the emerging markets. We had the chance to take two capable senior executives, divide their responsibility, take the two teams, merge them in an effective way, and this is just the next step in that evolution.

We have made one small acquisition to the second part of your point in the mechanical security area. That being said, small or large acquisitions in emerging markets particularly Asia, less so in Latin America are very, very difficult and time-consuming to exercise. You know, the integrity of the financial statements, business practices, a lot of other things where I think maybe rule of thumb is let's say in Western European or more appropriately North American markets of four things we look at, we might pursue two and acquire one.

In Asia of nine things we look at or 10 things we look at, we might pursue two and maybe acquire one just because it's a difficult legal environment. It is a difficult environment to confirm the integrity of the financials relative to the price expectation. It takes longer. Taxes are complex and as a consequence, we are not saying no to small bolt-ons, but what we are saying is they are hard to execute. They're very time-consuming so that will not be the driver.

Kate Vanek - *Stanley Black & Decker, Inc. - VP of IR*

At this point, due to the size of the Q&A queue and trying to be sensitive to the time before the market open, we are going to move to just one question. We are all available to take your follow-ups after the call, but in order to get some more questioners, we're going to move to one question only at this point. Sandra, next?

Operator

Stephen Kim, Barclays.



Stephen Kim - *Barclays Capital - Analyst*

Thanks very much. I just wanted to drill in a little bit deeper on the security margins going forward. You talked about an outlook for margins to be relatively flat. I just want to make sure we understand what basis that's on. Is that excluding acquisitions or is that sort of an all-in figure?

And at the same time if you could give us some sense of if you divest the HHI, knowing that that's not a definite yet, but if you were to, could you give us some understanding of what the margins looked like last year excluding that business in security? Thanks.

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

First part of your question, it is including Niscayah, so the operating margin rate that we are referring to would include the effect of Niscayah, so it's not excluding acquisitions and it's for the reasons I articulated I think the first question we had today, which is really due to the three areas, the four areas because Jim added on, which is to do the cost actions that we have taken and that we will be taking in the second half.

It's really continued execution on the synergies of Niscayah and the benefits we will see in the second half. It is the positive pricing trends that we've seen versus previous years, commodity and other inflation we've experienced. And then Jim talked about improved execution levels as well in the business and how we can convert backlog more rapidly and more efficiently to revenue.

As far as the impact of HHI on the segment, not a dramatic impact. It's not dramatically off from current line averages.

Operator

Ken Zener, KeyBanc Capital Markets.

Ken Zener - *KeyBanc Capital Markets - Analyst*

Thank you. Of the \$150 million benefit that you guys had initially, which is now rising, can you talk about how much fell in 2Q and 1Q as well as the inflation headwind at \$0.70? Can you talk about how that might have shifted given the macro changes? Thank you.

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

Yes, I would say that the \$150 million was executed in the first quarter of this year. We're now talking about another \$50 million that we will execute here in the month of July by the end of the month, early August timeframe. The vast majority of that was \$150 million was completed in the first quarter so you'd see a full effect of that in Q2 of \$150 million divided by four. So there's no reason why you wouldn't see that.

And then as I mentioned, the new actions would be \$50 million in the back half. As far as inflation, as I touched on, the \$50 million of negative mix impact around lower security and industrial volumes versus higher CDIIY volumes in our original guidance, embedded in there is a slight benefit to improved inflation outlook. So we clearly are seeing a little bit of deflation in certain commodities although we won't experience a dramatic impact to that in 2012 just due to the timing of really getting some of those price increases or decreases in place with our vendors and getting it through the inventory and the production of finished goods, etc. before it actually is sold to our customers and see that benefit.

I will remind everybody that we did experience significant levels of inflation so even though we are experiencing a little bit of deflation and expect to this year going into next year, we still have not fully recovered that inflation that we experienced in that timeframe back in 2011 and 2010.

Operator

Michael Rehaut, JPMorgan.

Will Wong - JPMorgan - Analyst

Hi, this is actually Will Wong on for Mike. Can you guys talk about the current pricing environment you are seeing especially within CDII? I know, Don, you mentioned inflation. Historically it's been offset by price by roughly 85% of that has been offset by price. Does that continue to be a reasonable assumption?

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

I would say that what we have said historically is that we believe our Company can offset -- Stanley legacy has offset 85% of inflation with price. Our new Company since the merger, we are trying to achieve those levels of objectives but we have also indicated that in CDII that percentage is much less and its higher, much closer to 100% in our Industrial & Security businesses or pieces of our Industrial & Security businesses.

So in CDII, I think if we achieve anywhere from 40% to 50% price inflation recovery through an inflationary period we've done well based on the current makeup of that business and the product lines.

Operator

Rich Kwas, Wells Fargo.

Rich Kwas - Wells Fargo Securities - Analyst

Good morning. On the timing of the potential deals, is the sale of HHI, is that predicated on doing anything with the engineered fastening business or does that have to leave the potential acquisition or could you do engineered fastening ahead of time? You feel comfortable doing that before an HHI sale?

Jim Loree - Stanley Black & Decker, Inc. - EVP and COO

These transactions are not interdependent, so any one transaction can occur without the other. We have the liquidity to do it and we have the financial capacity to do it, so it really -- we could end up with an engineer. As Don pointed out, we could end up with an engineered fastening acquisition and not a sale of HHI and we would be perfectly okay with that.

Operator

Nicole DeBlase, Morgan Stanley.

Nicole DeBlase - Morgan Stanley - Analyst

Good morning, guys. I was hoping to just dig in a little bit to the guidance change. So it looks like you guys are chalking up most of the \$0.35 to FX and if I do the math between the \$1.29 that you originally guided at and the \$1.22 today, I think you guys have said in the past that the \$0.01 impact of the euro rate typically results in a \$0.015 impact so that's giving me more like \$0.10 delta. So can you just explain what I am missing?

John Lundgren - Stanley Black & Decker, Inc. - President and CEO

Yes, 30% of our business is in Europe, Nicole. We actually do business in other foreign countries. But Don will give you the math on that.

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

That's just a portion of it, Nicole, and we gave that rule of thumb for the euro because it is a dominant component of our FX. But as I touched on in the call, and IK also touched on in our January earnings call is there's three major currencies that drive a big impact to our performance as a company. The euro is one. The Brazilian real is number two and the Canadian dollar is number three. That is about three-quarters of our international OM exposure around the world.

So we have to look at all three of those currencies to really get a true assessment. And if you look at how I described it earlier where we've seen at the beginning of the year, we saw about a 7% decline in the euro, 11% in the Brazilian real, 3% in the Canadian dollar. And then incremental to that since the beginning of the year, we've experienced about 5.5% decline in the euro to the dollar, the Brazilian real has declined another 10% beyond that 11%. And then the Canadian dollar has declined another roughly 2% since then.

And so as I mentioned, the first wave of that was about a \$0.45 impact back in January and the second wave is now a \$0.35 incredible impact on top of that. That's really the best way to look at it. I think the rule of thumb is great for just looking at the euro but you also to look at these other currencies.

John Lundgren - Stanley Black & Decker, Inc. - President and CEO

Particularly when in emerging markets -- Latin America, there's as much volatility as there has been of late. We have a \$750 million to \$800 million business in Latin America. Two-thirds of that is in Brazil and Don talked about the real so that's in your top line math, Nicole, that's a big, big piece that is excluded.

Operator

Michael Wherley, Janney Capital Markets.

Michael Wherley - Janney Montgomery Scott - Analyst

I just wanted to ask about industrial. It looks like you're factoring in 16% plus margins in the second half. Does that include European IAR getting worse since you said you expect overall Europe to deteriorate further in the second half?

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

I wouldn't say it's going to get dramatically worse from an OM or rate perspective in IAR. I think you also have to recognize the proactive cost actions that we are trying to take across the Company. Clearly a business like IAR that is suffering from economic circumstances is going to be contributing to that exercise in a significant way. So I wouldn't say it's going to drop off dramatically from where it was. Frankly I wouldn't be surprised if it's roughly continues at the same level we experienced in Q2 or in some cases maybe even slightly better.

Operator

Sam Darkatsh, Raymond James.

Sam Darkatsh - *Raymond James & Associates - Analyst*

Good morning, folks. How are you? I understand the financial rationale behind potentially selling HHI. I'm trying to fully understand the strategic rationale however based on two things. First off, if you no longer have HHI, your European exposure by definition goes up companywide. And then also I had always understood one of the benefits of having the HHI business is its -- the lockset business is a very high margin category for the retailers and therefore you are able to leverage those SKUs into getting more power tool listings at the home centers and so not having HHI may affect your market share.

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

Yes, Sam, the Europe's -- this is John and then I am going to turn it over to Jeff because you won't get a follow-up. That's after we pick Jeff up off the floor with his reaction to we have leverage in power tools because of lockset margins. Jeff is the expert and we will let him talk about a totally different departments, buyers and everything else.

But the -- it is math. To your point if we sell \$900 million worth of business that is overwhelmingly in the US and do nothing else, the math will be a higher percentage, not in absolute terms but a higher percentage of the total will be in Europe. Over time we'll shift away from that. We're not going out of business in Europe but the math is irrefutable.

Jeff, why don't you talk about the leverage you get in power tools from the lockset business or more importantly the lack thereof and exactly how that works in the home centers because you are our in-house expert.

Jeff Ansell - *Stanley Black & Decker, Inc. - SVP and Group Executive of CDIY*

Sam, I think you could draw the conclusion you just did reasonably. The fact of the matter however is that every one of these programs stands alone. And if you look at our size even as the world leader and market leader as compared to the size of the customers that support the HHI business, you would say that leverage is certainly a challenge at least. Beyond that, the chain is as strong as its weakest link so when you have an issue in any one part of your business, it becomes an issue.

When you have a benefit, it doesn't necessarily translate to a greater benefit. All of those things stand alone.

So there really has been no benefit to speak of in any way of the HHI business on the power tool business or vice versa. All those programs across various customers, departments, regions, etc., stand alone so there wouldn't be any impact that I could see.

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

Totally different buyers, Jeff, totally different departments. Different merchandising decisions, Sam. We talked about that a lot and we wished it were the case of putting Stanley and Black & Decker together because two large such suppliers to the home centers. But at the end of the day, we as a corporation are about 1.5% of a large retail -- of one of the large home centers revenue. And so dice and slice that, it's even a smaller piece.

So it's logical but in fact in reality, it's just simply lower not the case.

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

And if you look at the lockset business, of everything that we do in the home centers, it is the least differentiated. So it relies most heavily on its cost -- its brand appeal and its cost position. And therefore, it's somewhat susceptible to private label incursions over time.

One of the rationales behind the Tong Lung acquisition was it gets you the world, gets us the world's best cost manufacturing and provides an opportunity for the buyer of this business to participate in any private label business that might end up shifting from the branded business. But

for us, we are just not interested in doing a lot of private label business, so that's just another reason it is strategically less attractive to us than some of the other things that we do in CDiy.

Operator

Dennis McGill, Zelman & Associates.

Dennis McGill - *Zelman & Associates - Analyst*

Thank you, just to take advantage of Jeff a little bit more here. Jeff, can you talk about just domestically as it relates to the CDiy business? You talked a lot about market share. Can you talk about what prices are doing on an apples-to-apples basis maybe year-over-year, how you see the promotional environment today and how that impacts how you go to market? And then any quantification you can put behind the market share as you see it would be helpful.

Jeff Ansell - *Stanley Black & Decker, Inc. - SVP and Group Executive of CDiy*

The environment is not so different than it was over the last 12 months. Growth is at a premium. Competitors and retailers alike very aggressive. That said, I think our biggest benefit has been far better execution and planning promotionally.

So if you look at what we have attempted to do inside the year, we've moved a lot of things from one period to another, products from one to another and the desire is to make sure that we provide the greatest value to the end user, the greatest POS benefit of the retailer or customer and the greatest share gain opportunity for us. And we have moved a lot of things as a consequence.

The shortcut to thinking is we've done it before, therefore we need to comp it exactly the way we've done it previously. We have really abolished that way of thinking and revised our promotional plans in the space.

What you have seen us do is promote older legacy products more aggressively and make sure we hold that position while we enable the growth of lithium-ion products to flow through. So that has been quite positive and I would say all in all most recent period, just say that Father's Day the best example promotionally. Big season for every domestic retail customer. Our business was up greater in that Father's Day period than our POS average year-to-date therefore promotionally, we have been successful and you can see we were both successful and profitable in those endeavors.

Operator

David MacGregor, Longbow Research.

David MacGregor - *Longbow Research - Analyst*

Good morning. Good call by the way on the tactical plan. I like that. I wanted to ask Jeff a question on the CDiy. Demand patterns within the quarter, can you just comment on that please?

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

Demand was consistent throughout the quarter. We started relatively good position in April and carried through the subsequent two months. POS consistent -- relatively consistent across the period taking into effect the seasonal nature of June and Father's Day. Really nothing extraordinary in either direction, pretty consistently positive performance across the quarter.

Operator

Peter Lisnic, Robert W. Baird.

Peter Lisnic - *Robert W. Baird - Analyst*

Good morning, everyone. It seems to be an underlying theme of MPP or focus on it. Can you talk about any sort of cannibalization impact from that and maybe the margin implication of mixed moves toward more MPP broadly?

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

Sure, this is Jim. I would say, when we talk about MPP in the domestic markets, let's start with that or the developed markets. Definitely some shifting going on in both power tools and hand tools and commercial hardware. However, I think in power tools, we are very well situated with our Tradesmen line and with our revived Black & Decker line, which I think is outstanding to deal with any quote cannibalization and it's not debilitating cannibalization. In many cases, it goes from somewhat lower margin to higher margin business and maybe for a slightly lower purchase price.

So I think in the CDiy business, we don't really have a big issue there. We clearly do have an issue in the commercial mechanical security business, as I've discussed previously. That issue is in our case, we are getting cannibalized by the competition right now, so we have lost some share. So there's no internal cannibalization associated with us developing an MPP line. It is an absolute essential must do for us.

And in addition to that, we need to get more aggressive in the contract construction, commercial construction market as well. We historically have been much more of a retrofit business selling our products into the institutions such as education, healthcare and government that have multiple locations and require locks that can be converted and changed over time and replaced. So we are definitely doing something to address that with Tong Lung and what I described earlier.

Then we move to the developing markets and I think in that area, there's absolutely no cannibalization whatsoever. That is an opportunity, huge opportunity for us. It is a market that we don't serve, it's generally served by local competition, we do see the Bosch's and Mikitas starting to kind of poke around in there and start to try to figure out how to develop positions as well.

So I think we're all going to be involved in a land grab in this particular area in power tools, hand tools. I think we will have a better shot at hand tools obviously in terms of accelerated market share gain because the petition will be weaker and then in commercial security again, it's pretty wide-open space, a lot of local competition, no cannibalization.

Operator

Cliff Ransom, Ransom Research.

Cliff Ransom - *Ransom Research - Analyst*

Thanks, guys, for screening me and under the wire. First of all, thank you very much for your detail, very useful and in particular I appreciated your comment on the management depth as a factor in the acquisition lull.

I think the answer -- I'm going to ask two questions because I think the answer to the first one is no and the second one is more important. Is there anything you can say about Apex tools?

Number two, when I look at the portfolio, the one really big hole is that 4% in Asia. Can you talk about what you're going to do there please?

John Lundgren - Stanley Black & Decker, Inc. - President and CEO

The answer the first question is no. And the answer to the second question is yes, we would -- we have -- it depends on how you define Asia -- obviously Asia is a geography but we talk about the non-developed Asia Pacific markets. I think Jim has been fairly articulate on this on the last call and the portfolio transition. But simply said, our business has grown in emerging markets in total but that would include Latin America and emerging Asian markets from 10% or 11% at the time of the merger to 14% now.

We still feel that we are woefully underdeveloped in emerging markets. We think 20% is a target. We have actually publicly stated that. I think you are aware of that and it wouldn't hurt us I think to grow to 25%. That's the driver behind the formation of the SBUs that Jim talked about much at length on that one slide.

And as we think about Jeff Ansell's business, our IAR business, and to some extent our security business, particularly mechanical security, that's what's driving all these initiatives.

But in response to an earlier question, because acquisitions are much harder in Asia, they are a little easier in Latin America, we believe we're going to have to do it organically and I think Jim did a real nice job articulating that we are going to get serious about it. We're going to do it with internal resources. We're going to self-fund them with some of the cost cuts. And you are absolutely right, we recognize the void. We are addressing it but more with our own resources than via acquisition.

Jim Loree - Stanley Black & Decker, Inc. - EVP and COO

Also when you look at that logic of the engineered fastening acquisition, it's about \$200 million of revenue in Asia. So that would be a very nice incremental pop for what we are trying to accomplish there as well. The company is actually headquartered in Asia.

John Lundgren - Stanley Black & Decker, Inc. - President and CEO

Singapore.

Jim Loree - Stanley Black & Decker, Inc. - EVP and COO

So it is a -- that would be nice. And again, another one of the reasons behind the decision on capital -- reallocating capital.

Operator

Mike Kim, Imperial Capital.

Mike Kim - Imperial Capital - Analyst

Good morning, guys. Just turning back to Niscayah, could you talk a little about the pipeline you are seeing there in the overall market environment in Europe? Does that sort of suggest maybe a little more headwind relative to what we saw in the first half? Thanks.

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

As we mentioned, the performance in Q2 with Niscayah overall was about 5% pro forma revenue decline. And we continue to see pressures in our European business. As we went into the year we felt that we really had baked in 7% of an organic revenue decline for Niscayah associated with the

accretion from that acquisition in 2012. We still see that that's a likely possibility. We have also indicated if it got as bad as 10% for the year, we would be able to offset that with additional synergies and still achieve our accretion objective.

We don't see anything that changes that outlook at this point and we are prepared for a more difficult second half. In the security, electronic security business, you would tend to see an economic impact a little further down the road because we view there is longer term, longer lead types of revenue objectives or projects and then you don't necessarily see that as quickly as you would in the CDiy or an industrial business. So it would take a little longer to see that impact.

Operator

Greg Hessler, Bank of America Merrill Lynch.

Greg Hessler - *BofA Merrill Lynch - Analyst*

Thank you for taking the question. So if you guys are successful in selling the HHI business but you cannot acquire the engineered fastening business, can you talk about exactly how you plan to delever? And also do you have a particular credit rating target where if you look into delever two so you could hold onto a certain rating, how are you guys looking at that?

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

If that scenario played out where we decided to sell HHI but not acquire the engineered fastening asset, clearly we would delever a little bit, as I mentioned, because we would be losing about \$200 million of EBITDA and our objective would be over the next 18 to 24 months to get our debt to EBITDA ratio closer to 2 the way that the credit agencies measure it. And that would basically be strong investment credit grade. That's part of our financial -- long-term financial objectives and continues to be the case.

But there are occasions like this where we are slightly higher than that objective but we work it down to that level over a reasonable timeframe.

The most important thing is that in that scenario, we do buy back some stock to offset a significant amount of the earnings dilution associated with the sale of that business so we'd have a relatively modest dilutive impact of the net result.

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

That's tremendous flexibility per our comment to an earlier question from Jason Feldman at UBS. That is all US cash, so that gives Don and his team a lot more flexibility with respect to deleveraging buybacks etc. So it's a highly possible scenario but it gives us a tremendous amount of flexibility that we feel quite good about.

Kate Vanek - *Stanley Black & Decker, Inc. - VP of IR*

Sandra, I think that ends it for us today. Everybody who dialed in, thank you so much. Please reach out to me if you have any questions after the call.

Operator

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



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