Stanley Black & Decker Inc at Robert W Baird Global Industrial Conference (Virtual)

Chicago Nov 10, 2020 (Thomson StreetEvents) -- Edited Transcript of Stanley Black & Decker Inc presentation Tuesday, November 10, 2020 at 2:05:00pm GMT

CORPORATE PARTICIPANTS

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

CONFERENCE CALL PARTICIPANTS

Timothy Ronald Wojs, Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

PRESENTATION

Timothy Ronald Wojs, Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Great. Well, why don't we get started? Thanks, everybody. Good morning. Thank you for joining us. I'm Tim Wojs, and I cover building products here at Baird. And we're excited to have the management team of Stanley Black & Decker with us this morning.

Stanley is one of the largest global tool manufacturers. From the company, we have Don Allan, EVP and CFO; and then we have Dennis Lange and Cort Kaufman from IR.

We're going to -- the format of the presentation today is going to be fireside chat. So we're going to just go through some Q&A.

And maybe just to start off, Don. If you could just give us a little bit of a State of the Union, just kind of what you're seeing in your various businesses around the globe.

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

Yes. Sure. So about a few weeks ago -- it was almost 2 weeks ago, we did our earnings call for the third quarter and kind of gave a perspective on different scenarios we were seeing for the fourth quarter. And in general, I would say that the view of the world continues to be positive in a lot of different parts of the company and overall still positive.

Tools & Storage continues to be a strong growth driver for the company as we experienced in the third quarter 11% organic growth. We're expecting something similar in the fourth quarter. At this point in time, the trends through the first 4 weeks of October, we mentioned a few weeks ago, were kind of in line with our -- higher end of our expectations. And for the last 2 weeks since then, we've actually seen consistent trends in line with that. So there hasn't been any major deviations from those first 4 weeks.

And that's generally true across the whole company, not just Tools & Storage, and so that's a bit of an update in that sense.

But when you kind of break down the different geographies and start to look at what's happening, U.S. markets continue to be strong in Tools & Storage. European markets are healthy. They're just -- as we mentioned on the call, we had some significant growth in the third quarter. And we knew part of that, about 1/3 of it, roughly was really just kind of inventory restocking due to the major shutdowns they experienced in the second quarter. So we're seeing growth. We're just not obviously seeing that same type of restocking impact that we saw in the third quarter. And the same would be true with emerging markets as well. So in general, I think the tools, storage continues to be very positive.

We do have a few laggards, as we mentioned, in the industrial side of Tools & Storage, where it continues to be a little bit of slow recovery. But it is getting better sequentially, and there's aspects of that business that are oriented more towards construction, which are showing some green shoots. And so we continue to see more activity where the pro is kind of coming back to work. And as a result, we're seeing -- we believe there's more activity being generated our major customers with our products as a result.

And 2 other businesses, Industrial and Security, I'd kind of put in the same camp, just different kind of magnitudes and degrees. They're continuing to improve sequentially. We had about an 18% organic decline in Industrial in Q3. We're thinking that's going to be kind of low double digits for the fourth quarter, maybe mid, kind of 10% to 15% decline. And then Security had about a 4% organic decline in Q3. We think we're going to experience something similar but potentially a little bit better, maybe it would be closer to flat. And we'll see how things progress.

But for the first time in a while, they actually have a difficult comp to deal with, the last year's fourth quarter, where they grew organically 4%. So that's actually a very nice statement to make for our Security business because they have a difficult comp. It's kind of unusual for that to occur in the last several years.

So when I kind of look at the situation, it hasn't changed dramatically in the last 2 weeks. I think we're trending similar to what we described in the earnings call. And all indications are that the impact of some of the lockdowns which we're seeing in Europe are still pretty limited, and therefore, it's not impacting customer activity there.

But we're watching it very closely, in particular in France because -- and the U.K., for that matter, but probably more -- a little more in France just because we're heavily weighted to our tools business and our Security business. And so we're watching that very closely. But at this stage, we still feel pretty good about the trends.

QUESTIONS AND ANSWERS

Analyst: Timothy Ronald Wojs, Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Question – Timothy Ronald Wojs: Okay. Okay. Great. I forgot to mention this earlier. (Operator Instructions)

It's a good time in the year to kind of think about next year, Don. Could you just kind of outline maybe some of the swing factors that you might be seeing or might be expecting from both a revenue and a cost perspective into next year? I mean, you have some pretty easy tool comps in the first half, and broadly across the businesses, I think you've got some carryover cost savings. So if you could just kind of frame how we should think about the moving parts going into next year.

Answer – Donald Allan: Yes. Maybe we'll start with the things that are really kind of very tangible, and then we'll go to the last topic which is a bit of an unknown, which is the volume impact from last year. But I think we have a pretty good story there at this stage for volume.

But on the cost actions, yes, we have about -- we've done a significant amount of cost actions this year that started as a lot of temporary actions. And in June, July, we converted them -- many of them to permanent actions, in some cases, permanent headcount actions; in other cases, how do we make some of these indirect savings sustainable on a permanent basis going forward. And we've made a lot of traction in that regard over the last 3 to 4 months, roughly. And so now we feel like we have about $125 million positive tailwind related to these actions for 2021.

The other fact -- thing that I would say is there's no real headwind at this stage related to currency, tariffs or inflation/deflation as a tailwind. But -- so we're watching that. I think there's a little bit of inflation activity in some of the commodities, but it's very small at this point. And so currency has been pretty stable for the last almost 5 months, 6 months, relatively, had a little bit of flex here and there, but pretty stable from our kind of mix of currency.

And then obviously, tariffs, we haven't really seen much change there. And I don't expect there to be a change based on the current view of the election results. If there is a change, it could be positive. But I'm not even sure that would happen in a Biden administration. I think we'll continue to use that in the negotiation process with China. But I think the likelihood of more tariffs with China is probably very low probability at this point.

So we feel good at this stage that there's not any of these headwinds that we've been battling for 4 years now before the pandemic. And so we'll see how that plays out in the next 2 months, but there appears to be a situation where we will not have any significant headwinds as a result of those categories.

Now that being said, we've always gone into the year with a contingency. And the last couple of years, the contingency was really the programs we were doing under margin resiliency. And so we've continued to work on that over 2020, and we've built a funnel of activity for 2021 that will be somewhere between $100 million to $150 million of positive impact across things like Industry 4.0, commercial excellence and pricing, other transformation activities that we're doing in the back office around finance and IT and HR in particular. And then, of course, some things we're doing in the world of operations around transforming the manufacturing footprint results in some benefits as well.

So I feel pretty good about where we are with that, and that's a really solid contingency to have going into a very, I'd say, unstable situation at this point in time. So I feel great about the things we can control.

Now the one thing that we don't really control at this point is the top line volume impact. But that being said, when we look at the momentum we have in certain categories of our tools business, and it's really that kind of desire of activity that people have around their homes. And I think many of us realized that we're probably going to be in this environment virtually probably at least through next summer. The announcement yesterday around the vaccine gives us some hope that maybe that time line is very realistic. Not sure it can be much earlier than that just because of the -- how long it's going to take to get the vaccine distributed in really in a significant number of people.

But when you look at the centering of activity on the home, the more focus on e-commerce activities, which is beneficial for us in our tools business because we built that business for the last 10 years in a very significant way. We think we're well positioned for the first half of the year. And then you combine it with what you said, Tim, which is some really easy comps in the sense where tools was down 8% in Q1, 15% in Q2. And if we continue a strong POS in the first half of the year, which our major customers are planning for that, we're planning for that. And so you can see some pretty robust growth rates in our Tools & Storage business in U.S. retail in the first half of 2021.

You combine that with probably a similar situation in Europe, although not exactly the same, but there continues to be a lot of activity around the residential space in the European markets as well. That could be a positive. That would -- as they deal with the same type of comp issues. And their comp is much worse in Q2, in particular, because they have major lockdowns in several key countries for us.

So I think for the first half of next year, we feel very positive in the tools business. But we also feel positive for our Security business and Industrial business, where Industrial was down almost 30% in Q2, 8% in Q1. Security was kind of flat in Q1 and then down almost 8% or 9% in Q2. And so there's a positive momentum in those businesses, as I mentioned, sequentially, that would position us for -- be able to take advantage of that easier comp.

The bigger question, I think, in my mind, is what happens in the back half of the year. That being said, I think we're -- the types of things that we continue to do around innovation, we continue to roll out the Craftsman brand. I mean, one thing to remember is that the Craftsman suite of products is not fully rolled out. We rolled out the initial phase in a very significant way. And we're now looking at about $900 million in annual revenue in 2020 from that particular brand. We'll be rolling out more products underneath that brand in 2021, and that's part of our plan for next year, which we think will help us with market share gains in any environment that we're dealing with. So we think that helps position us for -- to able to deal with maybe some more difficult comps in the back half of next year.

And so although it may be difficult to grow our tools, storage in the back half because we might be dealing with a back half comp of 10%, 11% growth, but we don't think it's something where we're going to be protracting 20%, 30%. It might be a single digit number that we would track. And when you compare it to a very easy comp in the first half, and you'd start doing the math, you realize there is a path for this business to grow globally probably somewhere within our long-term financial goals of 4% to 6%, if it all plays out there. That assumes there's no major economic pullbacks and other things along those lines.

But I do think our businesses are positioned to grow mid-single digits organically, and some might be higher, some might be a little lower, depending on the comps we're dealing with for the full year. I really do feel pretty strongly that there is a path to do that under the kind of caveat I mentioned around economic circumstances.

Question – Timothy Ronald Wojs: Sure. Sure. And I guess if you marry that with your kind of normal incrementals and then you layer on the cost savings, you should be able to do EBIT growth probably in that kind of 10% to 12% range, at least initially.

Answer – Donald Allan: Yes. I think that's a really good perspective at this point in time is, if you look at our long-term financial objectives, to think, okay, we feel like we have enough activity and enough momentum on the top line under the circumstances I described. Then we'd say, okay, we should be able to grow 10% to 12% on the bottom line next year. And if things go our way, they're going to be better than that. But right now, I think that's a really good place to be.

Question – Timothy Ronald Wojs: Okay. Okay. Great. Maybe turning to some of the growth initiatives. On Craftsman, you reiterated the $1 billion target by '21. And really, that's despite a lot of the disruptions we've seen this year in COVID. I guess, where else can that brand go? When you think about $1 billion today, you're -- it seems like you're talking about that more as a milestone than maybe an end point. And so where else do you think that, that brand plays in terms of end markets or end products?

Answer – Donald Allan: Yes. I actually think the brand has a lot more potential than $1 billion and -- on an annual revenue basis. That was a number we threw out there at the beginning where we didn't even know who our major U.S. retail partner was going to be. We didn't know exactly how the e-commerce program was going to play out. But it's been a really kind of, as you said, kind of an incremental goal and objective that we've had. And we feel like we will probably hit that or beat that next year.

But I actually think it has the potential to be a $2 billion to $3 billion brand on an annual basis. It'll take time to get to that, but as you think about what I said earlier, there's still a lot of products we haven't rolled out that we will begin -- start that process next year and the year after.

Major customer like Lowe's, I mean, this is just a really important part of their tools strategy and continues to benefit both of us in that regard. And so they're going to want to continue to invest in the brand the way we want to invest in the brand. The e-commerce potential continues to be very significant as well. And I really think those are the 2 levers that are going to drive a lot of this growth when you combine it with additional products in this family.

There's some interesting ideas. Could it resonate in the U.K.? Could it resonate in Australia? I think those are things that we continue to kind of noodle on and think about, but they aren't necessarily in the top 2 or 3 priorities of focus right now. But over time, that could be something that we consider because I think the brand has more staying power beyond the U.S. And we'll focus on the U.S. market with major customers I just mentioned for the next year or 2.

But over time, I think there's potential for a little bit broader geographic reach, which, when you start doing the math of all those different things, it kind of puts you to a number that's close to 2 and then -- $2 billion. And then where does it go beyond that just through normal continued market share gains over time and innovation into the brand, that we'll continue to invest, obviously. And it really has a broad reach because it plays all the way to people like us who are just kind of doing selfers, to the tradesmen, to the -- even the pro like certain products underneath that brand as well. And so it has a very broad reach.

And then it goes beyond tools because it also goes into the outdoor world. So you also have the power of outdoor, the power of tools and the power of storage, which is really the 3 categories where that brand is incredibly powerful. And I think it has the potential to get back to where it was with Sears way back in the day, which is a multibillion-dollar brand.

Question – Timothy Ronald Wojs: Right. Okay. Okay. That's good to hear. On Black & Decker, I mean, that's something you guys have teased the market over the last 6 months. What's the -- I know it's one of kind of the last brands that you haven't made a big investment in. But what's the positioning? And what's the opportunity with Black & Decker? Because I think of Black & Decker as very DIY-oriented and it kind of had that cachet, but I'm curious kind of how you see that in terms of a price point and the distribution opportunity.

Answer – Donald Allan: Yes. I think it really has the potential to be an amazing global e-commerce brand, and I think it can resonate in a lot of countries around the globe. And it really, the brand -- if you think about where the brand is the most powerful, it kind of centers around the home or the household. So it goes well beyond tools. I mean, it's tools, it's outdoor products, it's appliances, all those different things. And we're not going to get in the business of necessary manufacturing appliances, but the licensing and the royalties and all that would be certainly part of that program as well. And it exists today.

But I think really making it a more robust e-commerce program in the United States. I think it will resonate very well in the U.K. I think it could resonate very well in China over time. And in other markets where we don't have a stronger presence, it might also resonate with a very similar type of categorization, such as Germany, Japan.

And so when I think about it, I think about the potential of how big it could be globally. And it would be a little bit different than how we do things with Craftsman and Stanley and DEWALT, which are really more oriented towards people using tools and with a heavy shift to tradesman and the professional. The -- although there are selfers that buy some of those brands for sure, but it doesn't tend to be the heaviest weighting of the purchasers of this category versus, I think, the Black & Decker brand is going to be primarily a DIY and tradesman brand.

And the tradesman brand would probably only be centered more in certain countries. Like the U.K. has a high perspective -- their tradesmen really think highly of Black & Decker, as an example. But there's also a strength of Black & Decker in the U.K. around kind of household products as well, such as vacuums, as an example. So I do think this brand too has the potential to be a multibillion-dollar brand over time if you think about all that potential.

And I think we have one of the best commercial leaders in the industry leading that effort right now in Jeff Ansell. I mean, he really knows how to do things like this. I mean, he was certainly a big architect of what we've done with Craftsman. He's been great at accelerating the growth of DEWALT and Stanley as we brought the 2 companies together under that business under his leadership. And now he's going to be focused on this for the next couple of years or so. And I think we're going to see the same about of success because he really knows how to commercialize these things and innovate these products and also to figure out what's the right price point for these products for it to be successful.

Question – Timothy Ronald Wojs: Okay. Okay. That's helpful. And then maybe going to MTD. Just, I guess, could you discuss the investment just a little bit? I mean, at the Analyst Day last year, you talked about some pretty meaningful growth, I think EBIT margins getting to kind of low double digits, I think a 25% increase in kind of cumulative sales. Any sort of update on kind of where that business is trending? And then just the ability to purchase the remaining 80% when you get to, I guess, July?

Answer – Donald Allan: Yes. So they're pretty much finished up their year at this point, and they had a very successful year. They clearly benefited, like we did, from this centering of activity around the home through the pandemic and experienced some really robust organic growth as a result. Their operating margin rates are kind of mid-single digits for this past year with a path to get to high single digits, maybe close to 10%, for next year's season. And so we really feel like they're trending the way we want them to trend on the profitability side.

And I think more encouraging to me or even more encouraging is that as we spend more time with them and we really think through the integration of the business, we see value opportunities beyond what they're going to do in the next 12 to 18 months or so. That make us feel comfortable that we can get to profitability, at least to 13%, 14%. And then I imagine as we continue to work at that, it can be something that we feel comfortable is more centered around 15%. And then we'll see where we go from there.

I love the innovation that they focus on. We're partnering with them through the agreement that we formed, kind of a joint investment committee that we formed. We're working with electrification with them on different products, both on the retail side and on the professional side. So that's continuing to make progress.

We still have more work to do to get the price point down a little bit in that category, but the technology works pretty well. Now it's more about how do you get the cost down to the price point as more comparable to gas solutions.

So a lot of good progress in that regard, and I feel pretty good about the progression. It's pretty much on track for the way that we had planned and hoped it would be. The option does open up in July in the next year. And so if you think about how their season works, they pretty much, by July, the bulk of the season is behind them from their perspective. They've pretty much shipped a lot of their products, and the activity that, that happens in August, September, is pretty low. And then October and November, they really start cranking up to the next season as far as manufacturing and shipping products out to customers.

And so I think the ideal timing from our perspective would be to say we're going to execute the option at some point in summer next year and maybe close on the transaction October 1 and November 1 at the beginning of their next kind of selling season because we'll probably need 30, 60 days of kind of government reviews that it needs to go through here in the United States. And so the timing actually would position well if the circumstances are right. And it's really going to depend on how does the company continue to improve along the lines I was describing earlier.

We feel good about our cash flow position this year. We think we're somewhere between $800 million to $900 million of free cash flow, with it leaning towards the higher number, which is a positive. So -- and if next year plays out the way I described related to the P&L, you feel good about there being a likely free cash flow number in excess of $1 billion for 2021 from the earnings potential as well as -- we probably will have some working capital benefit next year because we've had to really build a lot of inventory to deal with this high demand in 2020. It's a little bit of a negative drag on us. But even with that, we're still going to see a pretty robust free cash flow number for 2020.

So if all that kind of comes together, we're positioned well from a leverage perspective to maybe have that timing play out.

Question – Timothy Ronald Wojs: Okay. Okay. That sounds good. And then maybe just -- I think one of the other bigger takeaways from the call, Q3, was around margins. And it sounds like 18% to 20% margin is kind of the new base level within tools. Could you maybe just talk about why that's the right margin level for tools and just how you balance R&D and sales and other investments to make sure that you're continuing to grow above market?

Answer – Donald Allan: Yes. I think in the back half of this year, we're going to experience -- we just had a quarter from tools, it was 21.5%. So certainly, that's kind of at the very high end of the range, and there are a few temporary things in there that definitely propped that up a little bit. But even next quarter, we're going to be around 20% in this business.

So the back half is going to be somewhere between 20% and 21%. And so that kind of sets a new baseline for the business. And although we're going to continue to invest in the business, we also expect the business to continue to grow organically. And the leverage we get from that will give us some flexibility to invest in more innovation along the lines you were describing, such as engineering, more investment in e-commerce on the digital side to really make sure our brands continue to resonate with our end users.

We also have the benefit of margin resiliency, which gives us a positive impact, really heavily weighted towards tools. And so all those factors give us some tailwinds that allow us to continue to invest in the business and -- while maintaining the margin rate somewhere between 18% and 20%. I mean, if we started the business and didn't make a lot of those investments, the profitability probably would be above 20%. But as you said, it doesn't make a lot of sense because it doesn't really help you over the midterm and the long term. You've got to keep feeding the innovation machine of the tools business as it grows.

And as we see more opportunities in some of the categories that I mentioned, such as Craftsman and Black & Decker, that's going to require constant feeding of engineering activities, which result in innovation, the digital activities on the e-commerce front and continuing to invest in that as we become more and more heavily weighted to e-commerce, especially because of the Black & Decker strategy that we're going forward on.

So -- and then just -- we will end this year for Tools & Storage at 18%, right around 18%. So the full year of 2020 is already kind of there. And so now we're just trying to build upon that along the lines I just described.

Question – Timothy Ronald Wojs: Right. Okay. Okay. We've got a question here from the audience. Just -- are all of your kind of domestic manufacturing facilities now online and kind of producing at pre-COVID levels?

Answer – Donald Allan: Well, they're actually probably producing above pre-COVID levels at this point. Yes. All of -- to answer that part of the question, they're up and running, all our DCs, all our manufacturing plants are, not just U.S., but globally true. And then -- but I would say for our tools business in particular, on the power tools side and hand tools side, actually almost every category, I would say, we're running at max capacity right now to meet the needs that we're seeing in our customer base. Feels like it's going to be running pretty hot, at least for the next 6 to 9, maybe even 12 months.

Question – Timothy Ronald Wojs: Okay. Okay. And then another one here from the audience. In a situation that tariffs would kind of go away, how would that kind of play out for Stanley Black & Decker? I mean, I would imagine you'd get a pretty sizable benefit near term, but how would you think about the intermediate-term implications of that?

Answer – Donald Allan: Yes. It would be a very significant positive to our company. I mean, the total gross tariffs is about $300 million on an annual basis. There are offsetting actions that we've taken related to mitigating some of that number. It could be price actions. It could be moving production over time away from -- as we continue to execute our operating strategy, we're going to mitigate a lot of that just through that as well. So over the long term, we feel like we mitigate a lot of the tariff impact.

But that strategy is probably going to take about 3 years. So the better strategy, obviously, for us, would be that the tariffs get rolled back and we see a positive impact starting next year. But it would be in the hundreds of millions of dollars of a positive net impact to us on an annual basis.

Question – Timothy Ronald Wojs: Okay. Okay. Okay. Great. Well, we're out of time. So please join me in thanking Don, Dennis and Cort for being with us today. They're going to be available for a short breakout after this presentation. Other presentations in the room will be Inaspect, Chase Corporation, Methode Electronics, Zebra Technologies, AAR Corp. and Applied Industrial Technologies.

Thanks, everybody.
