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SWK - Q1 2018 Stanley Black & Decker Inc Earnings Call

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OVERVIEW:

Co. reported 1Q18 revenue of $3.2b and EPS of $1.39. Expects 2018 GAAP EPS to be $7.40-7.60 and adjusted EPS to be $8.30-8.50.

CORPORATE PARTICIPANTS

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

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

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

Jeffery D. Ansell *Stanley Black & Decker, Inc. - Executive VP & President of Tools & Storage*

CONFERENCE CALL PARTICIPANTS

Christopher Belfiore *UBS Investment Bank, Research Division - Equity Research Associate Analyst of Industrials*

David Sutherland MacGregor *Longbow Research LLC - CEO and Senior Analyst*

Michael Jason Rehaut *JP Morgan Chase & Co, Research Division - Senior Analyst*

Michael Robert Wood *Nomura Securities Co. Ltd., Research Division - Senior Equity Research Analyst*

Richard Michael Kwas *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Robert Cameron Wertheimer *Melius Research LLC - Founding Partner, Director of Research & Research Analyst of Global Machinery*

Robert D. Barry *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Scott L. Rednor *Zelman & Associates LLC - Director*

Takeheiko Makishi *Barclays Bank PLC, Research Division - Research Analyst*

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

PRESENTATION

Operator

Welcome to the Q1 2018 Stanley Black & Decker, Inc. Earnings Conference Call. My name is Crystal, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the call over to the Vice President of Investor Relations, Dennis Lange. Mr. Lange, you may begin.

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

Thank you, Crystal. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's First Quarter 2018 Conference Call. On the call, in addition to myself, is Jim Loree, President and CEO; Don Allan, Executive Vice President and CFO; and Jeff Ansell, Executive Vice President and President of Global Tools & Storage.

Our earnings release, which was issued earlier this morning and a supplemental presentation, which we will refer to during the call are available on the IR section of our website. A replay of this morning's call will also be available beginning at 2:00 p.m. today. The replay number and the access code are in our press release.

This morning, Jim, Don and Jeff will review our first quarter 2018 results and various other matters followed by a Q&A session. Consistent with prior calls, we are going to be sticking with just one question per caller, and as we normally do, we will be making some forward-looking statements during the call. Such statements are based on assumptions of future events that may not prove to be accurate and as such, they involve risk and uncertainty. It is therefore possible that the actual results may materially differ from any forward-looking statements that we may make today. We direct you to the cautionary statements in the 8-K that we filed with our press release and in our most recent '34 Act filing.

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

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

Okay. Thank you, Dennis. Good morning, everyone, and thank you for joining us. As you saw in this morning's press release, we delivered a strong start to 2018. The company posted solid revenue growth and earnings per share expansion overcoming approximately $50 million of commodity headwinds as we expected. Revenues were $3.2 billion, up 12% with organic growth of 4%, acquisitions added 6 points of growth and currency contributed 4%. These factors were partially offset by the Mechanical Security divestiture, which we executed in February of last year.

Tools & Storage led the way with 17% total revenue growth and with 6% organic. All major geographies and business units and tools contributed. This performance reflects a series of growth initiatives with great commercial excellence, aligned with SFS 2.0, a healthy global pipeline of market-leading innovations and FLEXVOLT, our first breakthrough innovation.

Industrial achieved better-than-expected results with flat organic growth. The team overcame anticipated headwinds from lower project activity within Oil & Gas and declines in Engineered Fastening, consumer electronics and automotive systems business.

Security posted total growth of 2%, as bolt-on acquisitions and currency offset a 1% organic decline.

EPS for the quarter was $1.39, a 7% expansion, as strong execution, acquisitions and lower expenses offset the significant impact from inflation. Don will provide you with a deeper dive into business level operating performance during his remarks, and Jeff, as he will cover shortly, tools acquisitions continue to be on track and we are working diligently and successfully to complete the second half rollout of the Craftsman brand.

We also executed an equity derivative transaction in the first quarter that had just the price of a future $3.2 million share repurchase for 3 years through March 2021 and that supports our long-term strategy to return approximately 50% of our excess capital to shareholders via dividends and share repurchases.

So in summary, 2018 is off to a good start and looks to be another strong year as we celebrate our 175th anniversary. On that note, 175 years ago, Frederick Stanley opened the Stanley Bolt Manufactory in New Britain, Connecticut. 10 years later, it was incorporated at Stanley Works and in 2010, it was merged with Black & Decker Corporation to create Stanley Black & Decker. Frederick was quite an entrepreneur and innovator and was also very involved in the community and that spirit of entrepreneurship, innovation, high performance and social responsibility was core to who we were 175 years ago and is alive and well today. And as you might expect, we are proud of this remarkable past and equally excited about our future as we celebrate 175 years.

When Frederick Stanley founded the company in 1843, I'm sure he could not have anticipated that his Bolt Manufactory would someday grow to a $13 billion revenue company with a market value approaching $25 billion and approximately 58,000 employees across the globe. It's a remarkable feat when you think about it and even more so when you consider that approximately 80% of the revenue growth and 90% of the market value creation has occurred since the year 2000 and just 10% of the company's history as measured in years. We are seizing the opportunity and building on this recent growth spurt.

Leveraging SFS 2.0, we are executing on a series of growth catalysts that will keep the growth coming in 2018 and beyond. FLEXVOLT has enjoyed the fastest adoption for a new product launch in power tool industry history. This high-powered innovative battery system is a growth driver today, it was in 2017 and it continues to be, and it's also stimulating demand for our 20-volt cordless offerings. We will continue to expand FLEXVOLT in the future with the ultimate goal of eliminating the need for cords on job sites making a dramatic and positive impact on workers' safety and efficiency.

Moving to Craftsman. The Craftsman transaction gives us the rights to develop, manufacture and sell Craftsman branded products in non-Sears channels. In 2017, we successfully established retail partnerships with a major home center, a major co-op hardware retailer and a leading e-commerce player. We're working with passion and excitement to enable the iconic Craftsman brand with its proud history to soon reclaim its rightful place in American homes, garages, factories and automotive shops. Stay tuned for a big launch in the second half of this year.

The Newell Tools integration continues to proceed on or ahead of plan, and we expect to meet or exceed targeted cost synergies and are now working to capture the significant organic growth benefits associated with expanding the Lenox and Irwin brands that we acquired with that deal.

And now I'll hand it over to Don Allan, who will walk you through the segment performance, overall financial results and 2018 guidance. Don?

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

Thank you, Jim, and good morning, everyone. Let's take a deeper dive into our business segment results for the first quarter.

Starting with Tools & Storage. Revenues were up 17% in the quarter, with 6% organic growth, 8 points of acquisitive growth and 3 points of currency. Price was slightly positive as we took actions in several emerging markets. The operating margin rate was 14.3% versus 15.9% in the first quarter of 2017 as benefits of volume leverage and productivity were more than offset by anticipated commodity inflation and modest growth investments. The strong organic growth and related share gains were experienced across each Tools & Storage region and SBU. On a geographic basis, North America was up 3% organically with growth across all channels. This performance included overcoming a slow start to the outdoor season due to extended winter conditions as well as planned customer inventory reductions, which occurred in the retail channel ahead of the Craftsman launch. We estimate these 2 factors combined reduced the North American growth by approximately 3 points in the first quarter.

The Craftsman transition impact was included in our plans as we prepare the marketplace to accommodate this exciting launch in the second half of the year, which you'll hear more about from Jeff later in the call. The U.S. commercial and industrial markets, both generated mid-single-digit growth and Canada contributed solid organic growth of 7%. Sharp commercial execution, new product launches and a supportive tool market continued to fuel North America's growth. Additionally, inventories within our major North American customers remained at normal level during the first quarter.

So in summary, both the underlying market and our performance still remains robust in North America as the 2 previous mentioned transitory factors are muting this region's performance for the quarter. We expect the growth to return to higher levels as we move through 2018.

Now Europe, delivered another solid performance with 7% organic growth. 9 out of 10 markets grew organically with double-digit contributions from the U.K., Iberia, Germany and Central Europe. The team continues to set the standard for commercial excellence as they leverage our portfolio brands, deliver a stream of innovation to the marketplace and expand our retail relationships to produce sustained above-market organic growth. The European performance continues to be a stellar example of how to effectively apply the pillars of SFS 2.0 to drive sustained outsized organic growth.

And then finally within Tools & Storage, emerging markets delivered another quarter of outstanding organic growth, up 15% with all regions delivering great performances. Diligent pricing actions, continued e-commerce strength and the ongoing MPP launch across the developing markets continue to support growth. Geographically, Latin America was very strong, headlined by double-digit growth in Brazil, Argentina, Mexico and Peru, while Chile delivered high single-digit results. Our change to a direct selling model within Turkey and Russia continued to fuel exceptional growth for those countries. And in addition, India, Korea and Southeast Asia were up double digits.

Now let's shift to Tools & Storage SBUs, where both businesses showed strong growth in the quarter. The Power Tool and Equipment group was up 5% organically, led by Professional power tools, which was up low double digits. Partially offsetting this growth was the Consumer power tool group, which was down in the quarter as the previously mentioned outdoor and Craftsman transition impacted this portion of the business. The Power Tool and Equipment SBU benefited from new product introductions, reflecting market-leading core innovation as well as the expansion of the FLEXVOLT system, along with the continued sharp commercial execution. FLEXVOLT continues to perform nicely as shipments were on plan for the quarter and we saw double-digit growth in both the North American retail channel and within Europe.

Our Hand Tools, Accessories and Storage SBU generated 8% organic growth on new product introductions, strong performances within the construction and industrial end markets and the contributions from Lenox and Irwin revenue synergies. Hand Tools & Storage was up 6%, while Accessories delivered an outstanding 13% growth, another excellent performance from this team.

So in summary, an outstanding quarter and a strong start to the year for the Tools & Storage organization in the face of significant commodity inflation.

Now turning to Industrial. This segment delivered flat organic growth, which was better than internal expectations. Similar to the scene from Tools & Storage, operating margin rate declined year-over-year to 16.4% as productivity and cost control were more than offset by commodity inflation and modest growth investments.

Engineered Fastening posted flat organic growth during the quarter as strong commercial activity was able to offset the expected decline in 2 areas: one, automotive systems due to lower model rollover activity from our customers; and two, in the consumer electronics business. The automotive business grew mid-single digits as continued fastener penetration gains more than offset the automotive systems decline. The fastener organic growth of high single-digit was well in excess of the 1 point decline in global light vehicle production. Additionally, the industrial fastener business continues to deliver value-added solutions to their customers, which enabled mid-single-digit organic growth in the quarter. All in all, a good start to the year for Engineered Fastening.

The Infrastructure business has posted an organic decline of 1% for the quarter. Hydraulic Tools grew organically more than 20% as they continue to see the benefits from the execution of successful commercial actions as well as the supportive market environment that benefits from higher scrap steel prices.

Meanwhile, Oil & Gas posted a low double-digit organic decline in the quarter as expected, given the lower pipeline project activity versus the prior year. While North American inspection project activities did provide growth, it was not enough to offset the declines on both the on and offshore pipeline businesses.

And then finally, the Security segment saw a 1% organic decline in the first quarter. North America organic growth was flat as higher automatic door volume was more than offset by lower healthcare volumes. We did expect to see slightly better performance from North America but customer timing did cause a shift in installation and project volume to future quarters in 2018. Europe organic growth was on plan, but down 2% organically as strength in the Nordics and U.K. were offset by anticipated ongoing weakness in France. In terms of profitability, this segment declined 100 basis points year-over-year. The operating margin was impacted by targeted investments to support organic growth and the sale of the mechanical locks business, which occurred last year at the end of February. The Security team remains focused on innovation with a particular emphasis on the application of digital technologies and advanced data analytics through their business model, along with commercial and operational effectiveness to position the business for sustained revenue growth and margin expansion in 2018 and beyond.

I would now like to take a minute to provide some comments on commodity inflation and tariffs. The table on the left is a reminder of our direct material purchases. We continue to see elevated commodity prices and as a result, now expect inflation headwinds to approximate $180 million in 2018, which is up $30 million versus our previous outlook of $150 million. Steel, batteries and base metals, they are the most significant commodities generated in this headwind. As you will see when we turn to guidance, we will be taking additional price, cost and productivity actions to offset this increased inflation.

Now let's shift to tariffs. First, I will address steel and aluminum tariffs under Section 232, which is included in our guidance released this morning. We now expect an annual impact from these tariffs of less than $3 million. This impact has been reduced from our previous comments on this topic as the country exclusions from Canada and Europe mitigated the majority of this potential impact. Good news on that front. As we look at our exposure for the initial $50 billion of tariff imposed under Section 301, we estimate a maximum annual headwind of approximately $40 million to $50 million if implemented. These tariffs could potentially impact componentry and some finished goods imported to support the U.S. market. However, there is significant uncertainty as to how this will play out, but at this stage, we believe these risks are at a manageable level for our company. We believe there are several mitigating factors, which could reduce this exposure to $10 million to $30 million annually including proactively reviewing our global supply base to identify actions that could lower cost as well as taking priced actions. Clearly, a number that we believe is manageable in our company size. Please note that any impact related to the first $50 billion in Section 301 tariffs is not included in our guidance given the uncertain nature of these tariffs and whether they even will occur.

So with that, let's head into 2018 guidance. We are reiterating our 2018 adjusted earnings per share guidance, which calls for approximately 5% organic growth and adjusted earnings per share range of $8.30 to $8.50, up approximately 13% versus the prior year at the midpoint. On a GAAP basis, we now expect earnings per share to range from $7.40 up to $7.60, which is inclusive of various charges related to M&A, including Nelson Fasteners and the refinement of the onetime tax charge from the recently enacted U.S. tax legislation. Keep in mind, the regulatory guidance surrounding the new U.S. tax bill continues to be issued and our estimate will continue to be refined throughout 2018 as we receive more information.

Now diving into a little more detail on our 2018 adjusted EPS outlook. You can see on the left-hand side of the chart, we expect the benefits from incremental price, cost and productivity actions as well as the modest contributions from the Nelson Fastener Systems acquisition to generate approximately $0.15 of EPS accretion. This will, however, be offset by higher commodity inflation, which includes the aforementioned $180 million of expected commodity headwinds in 2018.

We continue to anticipate approximately $50 million of core restructuring charges and approximately 155 million shares outstanding for 2018. And then lastly, we expect second quarter earnings to be 24% of the full year performance. This reflects the price cost dynamic we spoke about last quarter, where we will start to realize benefits from our price increases late in the second quarter, but we will not experience -- and we will not experience a significant benefit from these increases until the third quarter.

Now turning to the segment outlook on the right side of the page. Organic growth within Tools & Storage is still expected to be mid-single digits in 2018. We believe that the generally supportive market conditions in addition to several significant organic growth catalysts support an above-market performance in tools. The team is leveraging core innovation programs, FLEXVOLT, Lenox and Irwin revenue synergies, emerging markets growth initiative and the rollout of the Craftsman brand in the second half of the year. We continue to believe the top line growth will translate into improved margin rate year-over-year, even with a modestly diluted impact from the Craftsman brand rollout and the elevated commodity inflation being somewhat of a governing factor in 2018.

Now in the Industrial segment, we continue to expect low single-digit decline in organic growth. While the business performed above expectations in the first quarter, the market-related pressures within the automotive system rollovers and the lower levels of project activity within Oil & Gas will offset nice levels of growth within other parts of the segment. With the closing of the Nelson Fastener Systems acquisition, we are revising our segment margin expectation to be down modestly year-over-year. Nelson currently carries below segment average margins, but with cost synergies, we will get these margins up to line average over a reasonable period of time. Also, it is important to note, excluding this acquisition, we still expect operating margins in Industrial to be flat to modestly positive for the year.

Now finally in our Security segment, we are expecting the organic growth to be low-single digits in 2018. We continue to believe that the business can deliver a modest improvement in operating margins year-over-year as we maintain focus on cost and service productivity.

We also are reiterating our free cash flow conversion rate of approximately 100%. While we didn't cover first quarter free cash flow in detail, we did show some modest pressure year-over-year. The primary driver of that pressure was higher levels of inventory in Tools & Storage to support new product launches, including Craftsman. For those that have followed us for a while, having a free cash outflow in the first quarter is relatively normal due to our working capital seasonality. Working capital management remains a key pillar of the SFS 2.0 operating system, and we are confident we can continue to drive working capital improvements across the company with a heavy focus on improving the performance of recent acquisitions.

So in summary, we believe we are taking the appropriate actions to position the company to deliver a robust 5% organic growth with 13% adjusted EPS expansion, which is overcoming approximately $180 million in commodity inflation. In addition, we remain focused on free cash flow generation, of course, price realization, acquisition integrations and the rollout of the Craftsman brand.

With that, I would like to turn the call over to Jeff to provide some comments about our tools acquisitions and the Craftsman rollout. Jeff?

Jeffery D. Ansell - *Stanley Black & Decker, Inc. - Executive VP & President of Tools & Storage*

Thank you, Don. The Irwin and Lenox integrations continue to progress smoothly with cost and revenue synergies on track. We have successfully executed distribution center integrations in all regions. Notably, we completed the Irwin North America transfer into our North Carolina distribution center in February. These moves have improved service levels to the mid-90s from pre-acquisition performance in the low 80s. Additionally, we have completed warehouse migrations into our U.K. and Belgium facilities. And with several warehouse moves now complete, the vast majority of Irwin, Lenox product is now in Stanley Black & Decker facilities.

From a commercial perspective, we're seeing great traction globally with the Irwin and Lenox brands. We're excited to announce an Irwin brand revitalization partnership with Bunnings, the largest home improvement retailer in Australia. In addition, we are delivering revenue synergies in global emerging markets led by countries like Brazil and Mexico. Lenox is also generating momentum. As an example, our Lenox band saw business is up double digits.

Regarding the Craftsman integration, the legacy product lines are demonstrating growth with existing customers like Ace. In addition, we acquired Waterloo, the preeminent manufacturer of domestic metal storage products in July of 2017 and are leveraging it to produce a full range of Craftsman made in the U.S.A. metal storage products that are now ready to ship. As you can see, the acquisition integrations are proceeding nicely with much of the remaining milestones to be completed by midyear. Importantly, all brands namely Irwin, Lenox and Craftsman delivered mid-single-digit pro forma growth in Q1, consistent with our mid-single-digit core business growth.

Shifting to an update on the relaunch of the Craftsman brand. We have over 1,000 new products in development for the second half 2018 rollout. To build awareness and excitement for the relaunch, we'll begin to promote a portfolio of 30 Craftsman relaunch products, which includes mechanics tool sets, portable storage, metal storage, flashlights and more. At Lowe's, you can already see the first Craftsman relaunch items available online, and they are delivering strong performance. Additionally, there will be in-store promotional support for Father's Day. As planned, the broader set of over 1,000 Craftsman products will begin the rollout process in the second half of 2018 with completion in the first half of 2019 as planned. Ace will continue to support legacy Craftsman range until the second half of 2018 when they will begin to transition to the new Craftsman offerings, which will be completed during 2019. Ace will also participate in promotional support for Father's Day.

Regarding Amazon, Craftsman metal storage products are slated to roll out in latter 2018, and our plan is to have the broader product portfolio added during 2019. While plans and projections remain on track with these customers, we continue to pursue additional chain of opportunities across the globe. User and customer excitement remain high.

With that said, now I'd like to turn it back to Jim to wrap up today's presentation.

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

Thanks, Jeff. That detail you just shared on Craftsman, I think, will really open up people's eyes as to how real this really is in the second half and how enthusiastic we are about the prospects for that.

But getting back to the total company, to recap, the first quarter was a solid start to 2018 with a 12% revenue growth, the 4% organic growth and 7% EPS expansion despite those commodity headwinds. And as you heard from Jeff, the tools acquisitions are progressing well. We're on track with Craftsman in a big way, and as Don mentioned, we are navigating successfully through the price cost and other dynamics of 2018. And we're really fortunate to have on this call, the 3 management speakers, each of whom have 19 years of experience with this company. In short, we've been through all the cycles, inflationary, economic and other before and we know how to manage through them successfully. Thus, we position the company for a successful year and have reiterated our guidance for 2018, 5% organic growth, approximately 13% EPS growth. We're focused and remain focused on day-to-day execution, operational excellence, including delivering above-market organic growth with operating leverage, successful price realization and completing the integrations of our recent acquisitions and all the while generating strong free cash flow. And we're taking action strategically as well to continue to pursue growth looking forward as we pursue our 22/22 vision and become -- seek to become known as one of the world's great innovative companies to deliver top quartile financial performance and to elevate our commitment to corporate social responsibility.

With that, we're now ready for Q&A. Dennis?

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Tim Wojs from Baird.

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

I have a 2-part question, if I can try to sneak 2 in. I guess the first one just on Craftsman and then Lenox and Irwin. I was wondering if there's a way to maybe quantify relative to the mid-single-digit growth for the overall tools segment this year? What you might be expecting from those 3 things individually or combined? And then my second is just more of a modeling question. As you look to the ramp-up of Craftsman in the back half of 2018, anything we should just keep in mind in terms of any sort of cost in the second quarter? Or maybe any sort of product destocking? Or anything like that would be helpful.

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

Okay, I'll take that. This is Don. So just -- I'm not going to say, again, specifics about the impact of Craftsman throughout the year, but what I can tell you is that as we go throughout the year and I think we talked about this back in January as well, the organic growth for tools will improve a little bit in the second quarter versus the first quarter. So when you think about it kind of incrementally, 6% performance in Q1, see a bit of an improvement in Q2 as some of the Craftsman products starts to roll out although modestly, and then you'll start to see it improve again in the third quarter incrementally versus the second quarter. And then the fourth quarter will probably be a little bit down from the third quarter, but not significantly. So if you think about that kind of trend and how this rollout is going to work, a lot of the rollout may be more third quarter weighted than fourth quarter weighted but we'll see how that plays out. So think about the trend that way and a lot of that's being driven by the impact of Craftsman combined with, as a reminder, the cannibalization that has to happen during the second and third quarter as well as the fourth quarter. So there's product going in from Craftsman and there's some product coming out of some of our other brands, but I think that's the best way to think about that trend. There's no real unusual cost per se. We've baked in into our margin profile for the fourth quarter is really the impact of this shift in products from Craftsman and we're moving some of our other brands, which we previously mentioned will have a modest dilutive impact on the tools business in the company from a margin perspective. You also have the dynamic of commodity inflation as I mentioned that, as a result, you'll see margins in Tools & Storage will be down again year-over-year in the second quarter, but not as significantly down as it was in the first quarter. And then as we migrate to the third quarter, you'll see some incremental year-over-year improvement in margins and then a more significant improvement in the fourth quarter as all the full pricing actions go into place. So I think that's the best way to think about at this stage.

Operator

And our next question comes from Rich Kwas from Wells Fargo Securities.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

One for Jim, one for Don. Jim, on the M&A front, recent deal in the professional space here a couple days ago, curious on how you're thinking about incremental M&A, timing, et cetera, number of opportunities and what you think of the market? And then for Don, cadence to earnings, so first half of the year is based on your Q2 guidance, low 40s as a percentage of full year, that's only below what you normally have, usually mid-40s for the first half or better. I know there's a lot of things going on here, but could you just give us some feel or a comfort levels around hitting these higher numbers in the second half of the year as a percentage of full year? And what we should watch for?

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

Great. Okay, I'll start with the question on M&A. I assume what you're referring to in terms of our recent transaction was the sale of Greenlee and some other tool brands to Emerson, which was announced this week and -- for $810 million. It's probably the first tool transaction in a long time though that we haven't actually closed on. So I appreciate the question. I can tell you that we think Greenlee is a good asset with a certain value. When we got into the process of looking at it, the value, given some other attributes of the particular asset of 810 million was just a bit more than we had an appetite for. So very, very good asset and we wish Emerson all the best with that. We don't have to own everything. But we are very disciplined when it comes to value, price, et cetera on these types of things. Pipeline itself is very good, very good. And our digestion of what we've already acquired is going well. So you can only imagine that sometime in the not-too-distant future, you will continue to see acquisitions from Stanley Black & Decker. And as we've said in the past, you can potentially see those anywhere in the portfolio, because we really believe that if we own an asset or we own a particular business that -- and it's part of the portfolio, then that should indicate that we should be willing to invest capital in it because it has a future and a bright future. So pipeline is robust and we are selective though. And I think the Greenlee is a good indication of that discipline.

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

And on the second question related to the first half, second half, which is a very good question to ask. I mean, clearly, this year is a little bit different from a profile view and when you think about really 2 factors that are driving that. The first half of the year will have roughly 40% to 41% of our full year EPS performance in the first half. Historically, it's probably closer to 45%. So that's roughly $0.35 to $0.40 of EPS that's shifting. The biggest driver is commodity inflation. And so we have significant commodity inflation, Jim mentioned $50 million in the first quarter, really no price recovery on that $50 million of any significance. We'll have some partial recovery in the second quarter, but still we'll have a significant component of it that will not be recovered. And then you have the added dynamic of the Craftsman rollout in the back half, where you're getting a nice benefit of that rollout, not only on the organic line, but also in dollars of OM and in EPS. So it's really those 2 factors that are driving first half versus second half when you compare it to our traditional trends. And we're very confident in our pricing actions that we've laid out there. We have really 2 waves of them. We had $150 million of commodity inflation that we started the year. We said back in January that we thought 60% to 70% of that would be recovered in the year. We still feel good about that. So that's roughly $100 million of recovery that starts to be implemented in the second quarter and fully executed in the third quarter. Now there's a new wave of $30 million of commodity inflation that's happening, and we still feel the same about recovery. We actually think we can get 60% to 70% of that in 2018. However, those actions won't begin to be implemented until sometime in the mid- to second stage of the third quarter. And we feel pretty confident in our ability to do that because we've been focused on different surgical things that we can do in the area of pricing. As we've mentioned before, these usually end up broad-based price increases. Occasionally, we do that to certain categories where we think it's appropriate, but the vast majority of this price increase across the company is more surgical, where we see opportunity because of the inflation or we see opportunity because of our pricing versus our competitors.

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

And I'd like to make an additional comment on pricing because there is a lot of discussions surrounding pricing and whether we have pricing power in some of our industries, et cetera. And the reality is, when inflation is incremental and very modest but significant, it is somewhat difficult to get price in some of our markets because there isn't a significant story to go to the customers with and the channels with. When we get big slugs of inflation like we've got this year, those conversations aren't easy, but they are successful in general because it's just the reality of the situation. We're in business to make money and in order to do that, we have to achieve price increases to offset some of that inflation. And I think the other thing to mention is that every year, we generate 3% to 4% productivity very reliably and so to the extent that price does not necessarily cover all of the inflation. It is still possible to have margin accretion in this business because of the productivity that we consistently generate as a result of SFS 2.0 and other activities that we are pursuing.

Operator

And our next question comes from Michael Rehaut from JPMorgan.

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Michael Jason Rehaut - *JP Morgan Chase & Co, Research Division - Senior Analyst*

I'm going to stick to actually one question as you asked at the beginning of the call. I was hoping you could talk a little bit about Nelson and give us a little bit of sense to how that fits into the portfolio. It seems like in terms of that $0.15 offset to the commodity inflation that the acquisition accretion seems like it's a slight -- is a minority of that $0.15 given, Don, you said 60% to 70% of the $30 million could be offset this year to price. Just wanted to make sure I'm thinking about that correctly. And just more broadly, as you talk about Nelson, maybe you can also talk about the broader M&A pipeline and how that fits across the company as well.

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

Yes. So we actually like the Nelson Fastener acquisition. Obviously, we think it's a great addition to our industrial fastener business. So within Engineered Fastening, we have the automotive piece and we have industrial fasteners. This fits very well into that particular part of the business and it brings some nice additional products and technology that really is a great addition to that particular business. So a great addition to the portfolio. A continued expansion of really our niche expertise within fasteners that we can add value to our customers. On your question related to the accretion and the impact from Nelson, it is modest. And so the bulk of the positive accretion of that $0.15 is coming from price. The next significant piece is a little bit of productivity and other cost actions and then the smaller piece or the third piece of it is the Nelson contribution. Because we do have interest cost associated with funding it and obviously, we do have a tangible cost as well. So in particular, in the first year, it really offsets a lot of the OM accretion that we're going to experience with that business but as we go into next year, we'll see a nice uplift from that.

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

Yes. Keeping in mind that it's basically a $200 million revenue bolt-on acquisition. It does not have a dramatic impact.

Operator

And our next question comes from Steve Winoker from UBS.

Christopher Belfiore - *UBS Investment Bank, Research Division - Equity Research Associate Analyst of Industrials*

This is Chris. So just -- yes, so I just want to dig into Craftsman a little bit again. So with regard to Craftsman, the original expectation was for about $100 million of incremental sales 2 years from that business. And as I understand, the distribution through Ace Hardware is already achieving the sales number. So how should we expect this number to change as you kind of filter Lowe's and Amazon through? Does the Ace piece kind of go away or does that cannibalization of other product that you guys are taking off the shelves offset that? And then just kind of part of this, just in terms of margin, like where are we? Like what inning are we in terms of like the margin improvement of that business?

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

I'll have Don answer the margin part of the question but I would start by saying that when we acquired Craftsman, the assumptions that we utilized were based on -- were quite -- were based on a fair amount of uncertainty as it relates to how the commercial conversations would go with customers. We had a sense that they would be positive but a sense that they would be positive versus actually having an agreement, there's a pretty wide kind of variability between those 2 things. And as I think most people have gleaned by now, the conversations with -- have materialized into some pretty good results for the commercial agreements and therefore, I guess, going back to when we gave the guidance and the parameters for what we expected, we said it would be $1 billion deal but it would take 10 years. With all that uncertainty, obviously, we were very cautious and careful in terms of the timeframe. You can all come to your own conclusions about how that timeframe might be changing because the success of the conversations have gone so well. From our perspective, it's pretty mature to change what we've said previously but I can assure you that the directional aspects of this are favorable. And there will be more granularity coming out as the programs develop.

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

Yes. And just a reminder, back in January, I made the comment that as we go through the year, and probably in the back half of the year, we'll give a little better sense of how we think that program is going to play out in light of what Jim just said. On the margin side, yes, the margin of Craftsman, as we said, are below line average. And that's something that we recognize, we think through the things that we're going to do related to innovation and then bringing in the products in our manufacturing system, which I'll ask Jeff to give you a little more color on, on that particular program and how that's proceeding in our plan over the next 3 years. However, that's beginning in a situation that will be pressured to our margin. However, we do believe because of the size of our business, our Tools & Storage business, that over the time horizon, we will continue to be able to grow margin even with that pressure and that Governor on -- have any impact here in 2018 and likely in 2019 as well. But innovation will help us improve the margin and then the manufacturing strategy as well and I think Jeff can give us a little more color on what our manufacturing strategies and the status of that.

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

Yes, but just for clarity on the margins, we're talking specifically about margin rates. The margin dollars will be significantly accretive and strong.

Jeffery D. Ansell - *Stanley Black & Decker, Inc. - Executive VP & President of Tools & Storage*

Thanks, Don. In terms of manufacturing strategy around Craftsman, so we acquired an existing legacy business that had existing legacy products. The launch that begins this second quarter promotionally across Lowe's, across Ace and then replicated promotionally with both of those customers and with Amazon in the fourth quarter, those will be relaunched products, round up Stanley designs, Stanley manufactured products. And so far, that's going really well. 1,000 products in development but 30 of those products are manufactured at this point but they include products that we're really good at manufacturing. So Hand Tools manufactured in the United States, metal storage products and plastic storage products manufactured in the United States, Power Tools manufactured in the United States. So all of those things look really promising and the rollup plans look really good. We will improve the margins from want we acquired. The legacy margins of Craftsman were much worse but as Jim and Don said, in the early stages, they will be dilutive to our line average margins.

Operator

And our next question comes from Rob Wertheimer from Melius Research.

Robert Cameron Wertheimer - *Melius Research LLC - Founding Partner, Director of Research & Research Analyst of Global Machinery*

Could you comment on the competitive landscape in security for a moment? ADT seems to be moving more into the commercial, maybe that's different niches or different targeted areas then what you have but have you seen any change in commercial security yet? And is there any sort of separation between what you might see them doing and what you do?

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

I would say the change has been occurring over a longer period of time, and the competitive intensity has gradually increased. But in terms of short-term changes, it's pretty much business as usual in the commercial industry. The industry still remains incredibly fragmented despite the fact that we have a very large -- one very large player and another one that's increasingly getting into commercial. So nothing really notable there. I think there is a more strategic issue that we're dealing with and we'll deal with as we go forward, which is how do we reshape the value proposition of the business to make it even more differentiated than it is today.

Operator

Our next question comes from Michael Wood from Nomura.

Michael Robert Wood - *Nomura Securities Co. Ltd., Research Division - Senior Equity Research Analyst*

Wanted to ask you about price recovery from the commodity inflation. Can you just give us a sense historically how large productivity typically plays a role in keeping price cost neutral? Or do you eventually recover the commodity inflation with price alone, just with the lag?

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

Yes. So I'll take that. As we look at history and inflationary times, the 60% to 70% that I mentioned for this year and 2018 is actually consistent with history in the first year. Then we -- they obviously, have a carryover effect into the next year of that impact. I would say that we never really fully recover all the commodity inflation but we get pretty close, maybe 90% recovery. And when you look at it over a 2-year period of time, maybe 2.5 to 3 years, depending on the cycle that you're going through, and so history would say that that's probably what's going to happen. And I think what we're doing here in 2018 and 2019, it'll probably be very similar to that. Productivity is something that allows us to offset that 30% or so, or 35% that we have in the first year and then anything remaining, 10% or so that occurs in the subsequent year over that 2-year time horizon, we utilize that. And our productivity continues to be significant and it's something that we drive throughout our supply chain on an annual basis, as Jim mentioned.

Operator

Our next question comes from Julian Mitchell from Barclays.

Takeheiko Makishi - *Barclays Bank PLC, Research Division - Research Analyst*

This is actually Jason Makishi on for Julian. Just to the scope of that $180 million inflation guide, just wanted to check to see in the context of the visibility that you typically have, particularly in Tools & Storage around price cost dynamics, if there was scope for that maybe to come up as commodity inflation persists. And then on the other end of that, what would the incremental price action look like and would those be sort of difficult to push through just given the number that is already planned for?

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

The bottom line is we're confident to getting the price levels that we've talked about and the expectation that we would get more is probably unrealistic and that productivity will do the job that we've talked about. So I wouldn't bet on more price percentage recovery than has already been indicated but if more information comes, you can stand confident that we will continue to offset that in proportion to the previous recovery increases that we talked about.

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

Yes. And just a reminder, we haven't had an inflationary cycle like this in quite some time. But if you do look at our history and you want to go back that far, you will see that our approach that we're taking this year is very, very similar to what we've done in the past. And we believe, given where we stand in the market with the brands that we have and the products that we have and the innovation associated with that, we have the ability to take these actions and be successful because we do it, as I described earlier, in a surgical way, in a way that we really can be targeted to where it makes sense to do versus doing broad-based price increases.

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

Yes, and I would say the linkage also between our supply management organization and our commercial organizations in terms of understanding what the impact is as it's happening in real time, making that connection with the commercial organization and coming up with the tactics and -- the strategy and the tactics that are required to recover the price with the help of the financial organization, I think, is a very tight process here and one that's been refined, as I mentioned, over the years.

Operator

Our next question comes from Robert Barry from Susquehanna.

Robert D. Barry - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

I had a question on Industrial actually, and then maybe just a quick mechanical question. So you still see low single-digit decline there. I thought most of the pressure was expected in 1Q that came in much better. So I'm just curious where the pressure is going forward. Maybe you can give us some color on what's expected for the components within Industrial. And then just a quick question on this cap call transaction. Just curious, it's a little atypical why you kind of chose to do the repos that way.

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

Well, actually I'll take the cap call question and then Don will answer the Industrial question to the extent possible but the opportunity at this level to lock in a -- what we view is a very favorable share repurchase price was something that we elected to take because we really feel that the future of the company is very bright and therefore, locking in at today's levels is a sensible thing to do. Now why didn't we not just buy the stock, I guess, is the question with that as the context. And the answer is, I had mentioned earlier, the M&A pipeline is fairly robust. So when we make trade-offs between should we buy a very, very significant quantity of stock of this moment or should we lock in the price and wait to buy it in the future because we have a few things in the M&A pipeline that might come to fruition. All that goes into the thought process that ended up in the result of doing what we do with respect to the derivative.

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

And I would just add that a cap call, based on what Jim just said, really gives us a lot of flexibility. That's the benefit of doing something like that, what we would view as a very reasonable price. So on the Industrial question, there's 2 factors driving our view of the segment for the full year. The automotive systems impact will be ongoing throughout the year. So that will be a pressure to Engineered Fastening that might subside in the fourth quarter but it's likely just to continue throughout the entire year. And then the second dynamic is Oil & Gas. As I mentioned in my commentary, we continue to see low level of activities associated with pipeline construction. And as a result, we expect pressure to their business year-over-year. As they saw a really nice performance last year, certain pipelines were constructed here in the U.S. or North America. We don't see the same level of activity right now. It's really those 2 large dynamics that are driving that throughout the remainder of the year.

Operator

Our next question comes from David MacGregor from Longbow Research.

David Sutherland MacGregor - *Longbow Research LLC - CEO and Senior Analyst*

A couple of questions quickly on the emerging markets business. You put up some mid-teens growth in Tools, which was pretty impressive. I guess, how should we think about the pace of growth over the next year or 2 given the new products and the e-commerce penetration, expanding distribution? And also, how should we think about the incremental profitability of the incremental emerging market business?

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

I mean, emerging market is a major growth theme for us. It's something that we have invested heavily in over the last 3 or 4 years, something we've developed strategies for the emerging markets that involve several elements, including expanding our feet on the street, beefing up our management structure, undertaking some pretty significant product development over time to create MPP products and hand tools, corded power tools and cordless power tools. And just all in all, really taking SFS 2.0 and driving it into the emerging market world. And with great success, some of which has been masked over the past few years by massive foreign exchange headwinds that we've had, which totaled hundreds of millions of dollars over the past 4 years and have now subsided. So now, what you're seeing, I think, is the confluence of all those operational things that I talked about as well as the abatement of the FX headwinds. And the growth is excellent. The market share increases are taking place. It is almost pervasive across most of the emerging markets. There's a few areas that we're still kind of working to get to perfect the equation but all in all, it's a great story and it's something that -- I appreciate you asking the question because we don't talk that much about it but I think you'll find that that will fuel growth here in the future. As far as the margins, the gross margins are surprisingly consistent with the line average. The operating margin tends to be just a little bit lower because we are investing heavily in what I talked about. So to the extent that we invested a little less heavily, which we have the flexibility to do if and when we want to do that, the operating margins will be very consistent with the line average. In the meantime, we're investing in growth.

Operator

And our final question comes from Scott Rednor from Zelman.

Scott L. Rednor - *Zelman & Associates LLC - Director*

I was hoping you could talk about the outdoor business. Don, I think in prior conferences or calls, you described it as maybe a $300 million business. So could you maybe just conceptualize how that would seize, I guess, through the year and if you guys are seeing it come back in April at all?

Jeffery D. Ansell - *Stanley Black & Decker, Inc. - Executive VP & President of Tools & Storage*

This is Jeff, I'll take the question. The outdoor business for us is just a little less than 5% of the total Tools business. Obviously, seasonal. So we did see pressure in that business in the first 3 months of the year, probably like every company that participates there based on weather patterns. So what we saw was the coldest March in 4 years and it comps against what was a pretty good first quarter last year for most seasonal companies. So with that said, our listings remain very good. A lot of additions so -- new Black & Decker innovative items as well as new DEWALT innovative items. So placements look quite good. We do expect that to come back in the second quarter. What you do tend to find with outdoor is that just because of the compact nature of the season, it doesn't come back 100%. There's just not enough time for that to happen. So we do expect some recovery in the second quarter in the guidance we provided, not a full recovery. But again, it is a relatively small percentage of the total business, and we continue to do quite well in that area.

Operator

And that does conclude our question-and-answer session for today's conference. I would now like to turn the call back over to Dennis Lange for any closing remarks.

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

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

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a wonderful day.