REFINITIV STREETEVENTS

EDITED TRANSCRIPT

SWK.N - Stanley Black & Decker Inc at Morgan Stanley Laguna Conference (Virtual)

EVENT DATE/TIME: SEPTEMBER 13, 2021 / 7:45PM GMT

CORPORATE PARTICIPANTS

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

Lee B. McChesney *Stanley Black & Decker, Inc. - VP Corporate Finance & CFO of Tools & Storage*

CONFERENCE CALL PARTICIPANTS

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

PRESENTATION

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

Good afternoon and welcome back to Morgan Stanley's 9th Annual Laguna Conference. I'm Josh Pokrzywinski, the firm's electrical equipment and multi-industry analyst. Joining me for the next fireside discussion is Stanley Black & Decker. With us today, we have Don Allan, President and CFO; Lee McChesney, VP of Corporate Finance and the CFO of Global Tools & Storage; as well as Dennis Lange, VP of Investor Relations.

Guys, thanks all for taking the time. Pleasure as always, of course. Like I say, in front of all these, wish we were doing on the beach in Laguna, maybe next year. We'll see how that goes. Before we dive in here, though, I do have a quick disclaimer I need to read, that for any research disclosures, please see our disclosure website at morganstanley.com/researchdisclosures. (Operator Instructions)

So with that, Don, I know you have a few opening remarks you want to make. We'll dive into Q&A after, but take it away.

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

Great. Thank you, Josh. And as many of you know, we sent out a presentation. I'm going to go through a few pages of it. We obviously have our normal cautionary statements for you folks to take a look at.

Page 3 is just really a summary of Stanley Black & Decker, a bit of a refresher: size of our revenue last year, $14.5 billion; market cap, cash dividend yield, the structure of the 3 different segments; so clearly, Tools & Storage, making up a very large portion of our company; and the vision of really wanting to be known for innovation not only in our industry but outside our industry; continuing to be a top-quartile performer; and really even further enhancing our focus on social responsibility.

As many of you probably saw, we had a Growth Summit back in May. And we had some key messages that we wanted to get across related to this Growth Summit: continue to build a great company that's people-oriented and a dedication to performance, innovation and social responsibility. You just heard that about the vision I mentioned in the previous page.

Continue to demonstrate our strong track record of performance and shareholder return. That track record is something that we're proud of, but it's something we want to make sure we continue on a go-forward basis. Maintain our strong position to benefit from trends that are accelerating during this pandemic, which means there's a significant amount of potential growth catalysts for us. And I'll touch on those in a few minutes.

We have developed a substantial tech-enabled program to support sustainable margin expansion. And you heard about that at the Growth Summit from Lee McChesney around our margin resiliency program. Those are the key messages that we wanted folks to take away and then the same key messages we want people to understand today. We are focused on growth, and we are focused on continued margin expansion.

So when we think about the growth opportunity, we really believe that there's some significant secular trends that have changed and will continue to be out there for some extended period of time. The first is e-commerce. That's obvious to everybody. But we have made a significant investment over the last 10 years in e-commerce and built a business that's approaching 20% of the total revenue of our Tools & Storage business on the e-commerce side of it.

The reconnection with the home and garden, which is all of us have been home for various reasons during this pandemic, but for the most part, due to shutdowns and all those other activities. Now we're in a different phase depending on what country you're in. In the United States, you have the ability to move around. But in many cases, people have not returned to the office in a significant way given the Delta variant and potential impact of that.

Other countries in Europe have continued lockdowns, and that has really continued the intensity of this reconnection with the home and people wanting to buy bigger homes, renovate their homes, have projects outside their homes in their garden, et cetera. And we think that's going to continue. We have things such as the Black & Decker relaunch of that brand and accelerating the opportunity going forward to turn that into, hopefully, just an incredibly significant consumer brand over the next 3 to 5 years.

Then there's the electrification opportunity of how do we continue to electrify gas engine products like we did with our handheld outdoor products, in particular. How does that happen with a company like MTD, where we have walk-behind mowers, riding mowers and bigger platforms that professional landscapers use as well. That's a big growth opportunity as we convert that market with the technology that we've developed and continue to develop around electrification.

And then we have an opportunity in the Engineered Fastening business as automotive -- the automotive industry continues to electrify. And we talked about the growth and how that is not only a growth opportunity for us because we're so well positioned with the carmakers that make electronic cars, but it also enhances the content of how often our product is used in those types of cars, which means higher revenue opportunities and improved profitability.

And then last but certainly not least, the whole set of solutions that have been developed in our Security business around health and safety are so relevant to this environment, where people are trying to deal with the right levels of safety, both health and security around retail environments, commercial buildings, health care institutions, et cetera. And you're starting to see all these different growth initiatives have an impact on Stanley Black & Decker and we believe will have a very significant impact on us over the next several years as well.

So our opportunity is big from a growth perspective. We think it's something that will continue to drive top line growth. And then the things that we do around margin resiliency, pricing in response to commodity inflation will ensure that we achieve the right levels of profitability as well going forward.

So that is my opening comments, and I'll pass it over to Josh for Q&A.

QUESTIONS AND ANSWERS

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

Thanks, Don. (Operator Instructions) I guess, first and foremost here, Don, probably no surprise, you can anticipate the question we've gotten it and gone through it with pretty much every attendee today, is that clearly, the supply chain has gotten tougher over the past, call it, 60 days.

I'm sure you guys have probably observed, it's gotten tougher over the past 2 years or maybe even 5 years, but the -- that notwithstanding, what have you guys seen out there in terms of disruptions, just ability to get product, cost of procuring that, things like labor, logistics? Pretty broad topic, but it seems to be a pretty big point of consternation for folks. How does Stanley see that? And what are you guys doing to mitigate it?

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

Yes. So we definitely are experiencing what everyone else is experiencing related to supply chain. We have seen -- really focused in a couple of different areas. One is we were scrambling for quite some time to get more battery cells, lithium-ion battery cells for our power tools.

Now I think we've made great progress in that area. We continue to focus on how we increase that supply and that capacity as we close out this year and go into next year. I feel like that -- I wouldn't say we can claim victory, but I feel like we've made a lot of progress in that area.

The one area that's a bit of a log jam right now is what we call electronic components that are put into our power tools, where the microchips or the wafer chip goes into those components. And with all the things that are happening with the demand around chips, that's an area that we're definitely seeing some friction. So far, we've been able to meet the expectations that we have out there, but that's an area that we are watching very closely and continues to be challenging.

We're looking at this in a couple of different ways, very similar to battery cells. It's a short-term need and how do we meet the need out there? And then, how do we meet the need that we think is coming next year and the year beyond? And we believe that we are going to be in a significant growth period for our tools business in our outdoor product business for some period of time at probably 2 or 3 years.

We are planning for significant growth to occur next year, and we're building a supply chain around that to meet the needs, probably above what market growth will be, but we want to be able to also restock inventory throughout the channel.

We want to be able to make sure that our inventories are at the right level as we navigate through this. So the microchip piece is the biggest area that we're focused on right now is causing a challenge for us in 2021, and we're working on really making sure that doesn't become a challenge again in 2022.

The last area I'd mention is just logistics of moving around our product from one part of the world to another. The best example is -- I can give you is that if you send something from the Asian shore to the North American or European markets, let's use North America as an example.

Before the pandemic, it used to take 30, 40 days for that to play out. Now it's taking about 70, 80 days. It's almost double the amount of time that it used to take because it's difficult to move things through ports. It takes longer to move product across the ocean in certain categories, such as freight and trucking. And the cost of all that is much higher. So as you navigate through that, these costs have gone up dramatically, which is also a challenge as well that we're working through.

And so we think we can navigate this successfully here in 2021 to meet the expectations that we've put out there, but it will be tight. It will be a tough challenge. And then just as importantly, we're building a plan and a framework to ensure that we can meet the needs of what we think will be a continued robust market in 2022 as well.

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

So a lot of what you said there, I think, is consistent with what we've heard elsewhere, but one thing that sort of stuck out to me is really around procurement product availability. You mentioned batteries, you mentioned chips, kind of, I think, areas people would conceptualize pretty easily.

Those seem to sound more like demand issues in terms of, can we meet the demand that's out there versus margin issues? Is that -- would you describe it the same way in terms of the tension the way you guys see it on the P&L? Or is it a little bit of both?

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

It's a little bit of both because I think right now, the bigger challenge is on the demand side, meeting the demand, but it's also causing inflationary issues. And so cost of battery cells continues to go up. Cost of electronic components and wafer chips continue to go up. Clearly, the cost of the logistical aspect I mentioned continues to go up.

So we're dealing with a bit of a double dynamic here in 2021, where we're trying to meet the demands that we put out there for a forecast. There's also demand above that most likely that's going to be hard to meet. So how do we make sure we meet the expectations of the forecast we put out there, but at the same time, deal with the P&L pressures along the lines I just described? So it's a bit of a double whammy that we're experiencing at this moment in time that's most likely to continue throughout the remainder of this year.

The good news on the cost pressures is that, at least the commodity component of that, we are implementing significant price increases during Q3. And all of that should be completed this quarter, which means we get a partial offset in Q3 and a much more significant offset in Q4 to those pressures, and then obviously into Q1 and Q2.

These pressures continue, though, so we're continuing to look at potentially additional price actions, surcharges. And then how do we respond to this cost-to-serve component, which felt like it might be more temporary 3 to 4 months ago is becoming more of a permanent increase at this stage. And so do you put some type of surcharge or price increase in place related to that?

So we have a lot of different things in motion here to meet the objectives of '21, but at the same time, making sure that we're really positioning ourselves well for significant growth and continued profitability improvement in '22.

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

So on that price commentary, that sounds like maybe a different message than what we would have heard in '17 or '18, when the market seemed a little bit more resistant to price, we'll say. Has that sort of been your experience that no one likes to take a price increase, but it's sort of ubiquitous at this point so no category is immune, including things like tools? Fair assessment?

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

Fair assessment, and I'd ask Lee to give a little more color on kind of our history and what we're expecting this time around. But I think the way -- overall, the way you describe it is a fair assessment. Lee?

Lee B. McChesney - *Stanley Black & Decker, Inc. - VP Corporate Finance & CFO of Tools & Storage*

Yes. Sure. So Josh, in the past, we would have talked about doing price increases and hoping to yield maybe 1/3 to 50% offset to the inflationary pressure. This time around, as you said, ubiquitous might be the right word here. There's a lot of pressures in the world on the inflationary side. We're going after a 100% offset.

And at this point to what we initially saw as inflation, we think we're close to being on half that, at least in terms of bringing that price to market, then you obviously have to see how it plays out in the marketplace. But we think we're going to be significant yields higher than we've seen in the past, which will help with this -- in this inflationary environment.

To Don's point earlier, we're going to still [monitor down] on the pricing environment but also this cost environment. So there is a little bit more commodity pressure creeping out there. And this cost to serve is certainly -- continue to increase here throughout the quarter. So we'll look to do more in response to that as well, and we'll look for a similar type of ratio because, again, I think it's just a different environment now than it was in 2017 and '18.

But I'd also say, 2017 and '18 prepared us well for now. Through our margin resiliency efforts, we've built a tremendous pricing capability within the organization so that not only do you do a good job bringing price to market, but making sure you navigate those markets and get as much of that as possible to stick as possible. Because you do have to participate in the market and make sure you're -- we keep the demand to use where we want them as well.

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

Got it. That's helpful context, Lee. I appreciate that. I guess maybe a good jumping-off point for the long-term strategy around procurement. You guys have been sort of redomiciling that before the word nearshorings have sort of lost all meaning because we say it so often. I guess, today, is that's something that is, one, proving to be such a good idea that you'd like to accelerate it? And two, is it giving you some competitive advantage that allows for that sort of price yield?

Because I got to imagine your competitors are in an even worse spot on procurement and delivery times and inventory positions and all that kind of stuff. And at the end of the day, there's nothing worse than a missed sale entirely. I would imagine that some of those more Asia-bound supply chains are at risk for that.

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

Yes. We couldn't agree more. I mean the opportunity that we've been talking about in our strategy for at least 5 to 7 years roughly is that we want to get closer to our customer related to our supply chain. And we've achieved that in our Industrial businesses. Our industrial businesses have had a long legacy of being -- having their manufacturing and their vendor base very close to where the customer is that they serve.

In the Tools business, that has not been the case. And we've been -- before the pandemic gradually migrating more and more production and more and more capabilities to the North American market and some to the European market as well. That has to continue. And I think the opportunity continues to be significant.

And when you look about -- look around at technology such as Industry 4.0, which allows you to highly automate and digitize your manufacturing plant and the relationship that you have with your vendor base, it really does free up where you manufacture. And so you're no longer focused on the labor aspect being the main driver of the decision. You're more focused on, how do I get this closer to the customer to make the supply chain leaner, have the ability to respond quicker to times when you need to do that, whether it's meeting higher levels of demand or recessionary periods of time?

And so that strategy couldn't be more relevant than it has ever been, and it's something that we continue to execute on. The interesting dynamic right now is that with the growth that we've been experiencing in our Tools business, what we're doing to meet the demand is basically we're opening up new facilities in North America, some in the European markets. And that's really helping us meet the demand. And we're not, at this time, shutting down production in Asian markets at this stage.

Now maybe that shifts and changes eventually. But what's interesting is all the new growth is going to come from serving from facilities that are closer to the customer. And therefore, you may get through this in the next 2 or 3 years and find out you have a very balanced supply chain when it's all said and done because you've been able to leverage those technologies in Industry 4.0 and you've been able to get much closer to your customer for the vast majority of the products you make.

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

What do you think is the right mix of produced where sold versus low-cost country sourced?

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

I think if you're somewhere between 60% to 75% local, you're probably in a good place because that means you're taking what we call your AA or A products, your top-tier products and some of your Bs and you have them local. And then the ones that are kind of B-, Cs and those types of things, which are good products but they're just maybe not the same levels of profitability, maybe they don't serve the same level of demand, but they're a needed product as an adjacency to the kind of the A product or AA products that we sell as well. I think that's where you get a mix.

My guess is for the U.S. market, probably 70% to 75% is the right amount. I think the European market, you could do something that's probably 55% to 60%.

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

And you're 30% to 40% in the U.S. today, give or take?

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

We're over 40%, yes.

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

Over 40%. Got it. So just shifting to maybe the more fun part of the discussion on how strong demand has been. It seemed like a year ago, the sustainability of demand and tough comps were kind of the normal course of action. It seems now like we've at least extended that by a year, and you guys have a bit more of a unique position with this DIY-to-pro handoff.

Whatever analogy you would want to use, baseball or otherwise, how do you think about how that handoff has gone? Has that already taken place? And if you start to see DIY normalize but continued strong new construction and renovation activity, can that still be -- is that still a formula for growth in overall Tools in '22?

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

Yes. I think what we're seeing right now is you've got some really strong professional demand that's playing out. And DIY is slowing a little bit in the U.S. market for sure, but it's not slowing down dramatically because there's still a lot of people that their main center is their home. And so there's a fair amount of people that are still investing in their home and they're doing it in their own way versus bringing a professional in.

So it hasn't had this massive retraction that certain folks were concerned about and worried about and maybe even we were worried about it at one point in time. So that retraction has been relatively slow in the U.S. market.

And then you've had other markets where the do-it-yourself phenomena continues to be strong, like in the European markets where the lockdowns have gone on longer, ability for people to move around has been fairly constrained. And so you're seeing a lot of that activity continue to happen in those markets, and that's one of the benefits of having such a global set of brands and portfolio of products as well that we're able to benefit from.

And so I think that when I go into thinking about 2022, there is a really good growth story here that I think these trends are going to continue. I think the do-it-yourself here will slowly, slowly start to mitigate itself. But then what could offset that, which we haven't spent a ton of time talking about, is this whole growth initiative we're pursuing with Black & Decker brand.

And that consumer orientation of all those products and how they can get sold to e-commerce channels and brick-and-mortar and the reinvigoration of the brand and the way the product looks and really updating it to something that is very appealing to the consumer and the do-it-yourselfer. And so -- and even though we may get that momentum going -- negative momentum trend going on the DIY side, you could have a much bigger offset as the Black & Decker growth initiative begins to take off later this year and into next year.

So our view of growth for next year for Tools & Storage is we think we can find a way to demonstrate a fairly significant amount of growth. We'll refine that point of view as we get closer to the end of the year into January and see where the markets are. But with all the growth initiatives that we have and so many of them centered around GT&S and this -- unfortunately, this virus really isn't going away.

So it is really continuing to constrain people's ability to do things beyond their home in a very significant way, we think '22 could actually be a very compelling growth story at this stage.

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

And just on Black & Decker because I know you did talk about it at the Growth Summit, maybe rank order that versus some of the other breakthrough innovation you guys have done. I mean FLEXVOLT is sort of a tall bar to leap over as would the CRAFTSMAN relaunch. So maybe those aren't the right comparison point. But it's still a big brand that hasn't really been part of the story. So that implies a good amount of white space. Like how do you guys think about where Black & Decker could be in a couple of years?

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

Yes. The interesting thing about Black & Decker is that it is a heavy consumer brand in many markets around the globe. It's also a tradesman brand in certain markets, certain European markets, a lot of the emerging markets with kind of a -- it's got great functionality, but it's got lower price points than a DEWALT and even a Stanley brand. And so therefore, it has that capability, and it's an incredibly global brand as well, obviously.

So when you think about reinvigorating it, it's about a little more than $1 billion in annual revenue. Today, it's a little bit higher than that here in 2021 likely. And I think this is, over the long term, a multibillion-dollar opportunity. I mean this -- for growth.

This is something that when you look at the consumer side and how we have not really aggressively pursued the Black & Decker brand through various consumer channels such as e-commerce and you reinvigorate the look of it, the functionality of it, and then try to push that through the tradesman opportunities that exist in certain countries around the globe, it could be several billions of dollars of additional growth over long periods of time. That's not going to happen in 1 or 2 years, but it could actually be even more compelling than what we experienced with CRAFTSMAN and will experience with CRAFTSMAN and certainly more compelling than what we experienced with FLEXVOLT.

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

Got it. Understood. And then just on the outdoor portfolio, obviously, the -- getting the deal done with MTD and then the Excel deal announced today, do you have critical mass in the categories that you want to be in? And how do you think about how much of that can really be electrified without pretty significant cannibalization along the way?

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

Yes. I think the electrification is a growth opportunity, and I think it's something that we look at as -- very similar to how we looked at the handheld outdoor product as that went from corded to cordless; very similar to what we experienced in power tools when it went from corded to cordless.

This opportunity will be significant, and it's a growth opportunity for our company over many, many years. And we're excited about that. And what's interesting about these 2 acquisitions is MTD serves the residential user. And so those of us around our home or use mowers, a lot of their products serve that channel.

The Excel opportunity serves a channel through independent dealers and commercial side of the business, which is professional landscapers and the needs that they have. And so we're really excited about both those opportunities, and we're also excited about electrification, obviously.

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

And I think within that, if we would have gone back a couple of years on MTD, I think the margin outlook, the growth would have started you a little higher on the initial accretion. Obviously, a lot of things have changed in the world since then. What in your mind needs to happen or could happen that could get us back into that state?

Is it just the case of input costs normalizing? Is there something about synergy relationship between Excel and MTD now that could unlock more profitability there? Just trying to think about, what gets us to that dollar of accretion on MTD within kind of maybe closer to the original time frame that you were thinking?

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

Well, I think the dollar accretion is certainly possible for MTD. I think when we look at what's happened in the last 12 months, there's some significant operational things that we need to solve with MTD, so their supply chain. And we feel really good about our road map to do that, but that's going to take time. You don't solve major supply chain structural changes in a short period of time. But as we continue to do that over a 3- to 5-year time horizon, we'll see a lot of value come out of that.

Splitting the 2 business together in MTD and Stanley Black & Decker, there's a lot of synergies for back office and those types of things. The one thing that we never put into our models is revenue synergies. And so the revenue synergies of MTD and Stanley will likely be fairly significant, and there'll be interesting opportunities that we can pursue that could be several hundreds of millions of dollars of revenue opportunities that most likely will be in channels where there's higher level of profitability. And therefore, that's another way to get the accretion up as well.

So I think a combination of -- we always tend to outperform our cost synergies to some extent. So we put a number out there, but we go for a bigger number. We don't put revenue synergies in our model, but then after year 1, we start aggressively pursuing them. And we tend to get very solid results out of that.

And then the third area is, yes, as we put the 2 businesses -- or the 3 businesses now of OPG, MTD and Excel, it does create, in particular in the back office in SG&A, an opportunity to really make sure we're lean and efficient. So I'm not scared of the dollar accretion. It's just a question how quickly it comes.

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

Got it. And I know we're at time, but I feel compelled to ask one last question around the portfolio. You've seen a competitor get out of their security business, arguably one with lower profitability. I think elsewhere out there in the broader industrial orbit, there are a few noncore tool assets that are floating around that may be interesting to somebody like Stanley.

Any kind of fresh evaluation on the portfolio that is taking place or kind of new review that you feel compelled to undertake with some of the new things going on in the market?

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

Well, I mean the timing is interesting because every year with our Board in October, we do a broad strategic review of the entire company and all the businesses. And we'll be doing that again in October. So now will, of course, be a discussion point. It will be something that we talk about and decide what the right next step is for our Security business.

That being said, we're incredibly excited about the growth that they're experiencing. They had 14% organic growth in Q2. They're probably going to have 7% to 9% growth in the back half of this year. And we think there's a path for next year to have growth in the high single digits as well.

So we're excited that these investments are really unlocking a lot of potential and opportunity for them. And so that puts us in a situation where we have to evaluate it because new events have occurred in the industry. But at the same time, we're also seeing this transformation continue to gain traction. And therefore, we have a lot of different things to discuss and decide around that.

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

Understood. Don, I appreciate your time as always. Lee, Dennis, to you as well. Good to see you all 3 of you. Hope to do it on the beach again next year. And in the meantime, be well. Thanks for joining us.

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

Thanks, Josh. Talk to you soon.

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

Thanks, guys. Be well.
