

27-Oct-2023

Stanley Black & Decker, Inc. (SWK)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

Dennis M. Lange

Vice President-Investor Relations, Stanley Black & Decker, Inc.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

Christopher J. Nelson

Chief Operating Officer, Executive Vice President, President-Tools & Outdoor, Stanley Black & Decker, Inc.

Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

OTHER PARTICIPANTS

Julian Mitchell

Analyst, Barclays Capital, Inc.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC

Michael Rehaut

Analyst, JPMorgan Securities LLC

Chris Snyder

Analyst, UBS Securities LLC

Nigel Coe

Analyst, Wolfe Research LLC

Rob Wertheimer

Analyst, Melius Research LLC

Joseph O'Dea

Analyst, Wells Fargo Securities LLC

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Third Quarter 2023 Stanley Black & Decker Earnings Conference Call. My name is Shannon, and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. 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 M. Lange

Vice President-Investor Relations, Stanley Black & Decker, Inc.

Thank you, Shannon. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's 2023 third quarter webcast. On the webcast, in addition to myself, is Don Allan, President and CEO; Chris Nelson, COO, EVP and President of Tools & Outdoor; and Pat Hallinan, EVP and CFO.

Our earnings release, which was issued earlier this morning, and a supplemental presentation, which we will refer to are available on the IR section of our website. A replay of this morning's webcast will also be available beginning at 11:00 a.m. today.

This morning, Don, Chris and Pat will review our 2023 third quarter results and various other matters, followed by a Q&A session. Consistent with prior webcasts 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 based on our current views.

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's therefore possible that the actual results may materially differ from any forward-looking statements that we may make today. We direct you to our cautionary statements in the 8-K that we filed with our press release and in our most recent 1934 Act filing.

I'll now turn the call over to our President and CEO, Don Allan.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

Thank you, Dennis, and good morning, everyone. Stanley Black & Decker's third quarter performance reflects the continued successful advancement of our strategic business transformation. Our focused execution resulted in improvements versus prior year in adjusted gross margin and earnings per share as well as free cash flow.

Reflecting on our journey over the last five quarters, we have made significant progress. One, our cost and inventory position is healthier behind the momentum of our supply chain transformation, and we are confident in the runway for this to continue.

Two, our execution is stronger and the results now demonstrate the focus across the organization to enhance the customer experience and improve our financial position.

Three, our performance to-date provides the solid foundation for the additional investments we are launching in innovation and market activation to capture the compelling long-term growth opportunities in the markets we serve.

Four, our view is that the markets will remain dynamic. Our focus is on delivering best-in-class product innovation through our portfolio of world-class brands, implementing cost efficiency measures within our control and driving share gain in our core markets, all aim to further improve margin, earnings and cash flow.

While there are many important steps ahead of us on our journey, I am confident that we have the right strategy, a highly capable and motivated leadership team and a strong competitive position to successfully execute our transformation.

Shifting now to our third quarter performance. Revenue was \$4 billion, which was down versus the prior year, primarily due to lower outdoor and DIY volume. The demand for our Pro Tools as well as automotive and aerospace fasteners remained healthy and demonstrated growth in the quarter.

Across our end markets, the US retail point of sale for our Tools & Outdoor products remained in a growth position this quarter versus 2019 levels. As we assess our competitive positions and demand trends, we believe that we are stabilizing our share position in a mixed market environment, while we continue to invest in market activation and field resources to drive future share gains. Our global cost reduction program delivered \$215 million of pre-tax run rate savings in the quarter, on track for the expected \$2 billion run rate savings by the end of 2025.

Adjusted gross margin rose to 27.6%, a 400 basis point sequential improvement and 290 basis points favorable as compared to last year. The benefits from our inventory optimization and supply chain transformation are now clearly being reflected in our performance. As we navigate uncertain market conditions, we are continuing to focus on what is within our control to improve our margins.

Looking ahead to 2024, we expect additional sequential and year-over-year gross margin gains. We delivered approximately \$300 million of inventory reduction this quarter, which brings us to \$1.7 billion reduction since mid-2022 when we started this journey. This contributed to over \$360 million of Q3 free cash flow generation, which supported our quarterly dividend and \$285 million of debt reduction in the quarter.

Benefits from lower supply chain costs contributed to third quarter adjusted diluted EPS of \$1.05, which was better than our plan. Our year-to-date performance supports increasing our 2023 full year adjusted diluted EPS guidance to a range of \$1.10 up to \$1.40, which would be up \$0.25 at the midpoint.

I want to thank our 50,000-plus employees around the world for their focus, dedication and passion that contributed to another successful step forward in the third quarter. Our progress is encouraging and I am confident that by executing our strategy, we are positioning the company to deliver higher levels of organic growth, profitability and cash flow as well as strong long-term shareholder returns.

Now shifting to our third quarter segment results. I will discuss our Industrial business performance and then pass it to Chris Nelson to review the Tools & Outdoor results. Third quarter Industrial revenue declined 4% versus last year, as price realization and currency were more than offset by lower volume and a 3 point impact from our Q3 2022 Oil & Gas business divestiture.

We improved Industrial's adjusted operating margin by 110 basis points versus prior year, driven by continued price realization and cost actions to deliver adjusted operating margin of 12.2% in the quarter. This represents strong execution and continued year-over-year margin expansion for our Industrial team.

Within the segment Engineered Fastening organic revenues were up 6%, including aerospace growth of 29% and auto growth of 9%, as we continue to capture the strong cyclical recoveries in these markets, which was partially offset by what occurred in industrial fastening. Our attachment tool business experienced organic revenue declines primarily as a result of customer destocking to normalize their inventory levels.

The long-term fundamentals for growth remains solid in all these businesses, and we believe the temporary channel inventory destocking in attachment tools will be complete as we exit 2023.

I want to thank the Industrial business for their strong execution. This is the fifth consecutive quarter of double-digit adjusted operating margin for the segment. We are excited by the runway for growth, share gain and operating leverage in these businesses.

I will now turn the call over to Chris, to review our Tools & Outdoor performance.

Christopher J. Nelson

Chief Operating Officer, Executive Vice President, President-Tools & Outdoor, Stanley Black & Decker, Inc.

Thank you, Don, and good morning, everyone. I am now at the 4.5 month mark at Stanley Black & Decker and this period has really reinforced my excitement about the future for this business.

I've spent my time with end-users, customers and our passionate and highly capable Tools & Outdoor organization. We have iconic brands such as, DEWALT, CRAFTSMAN, STANLEY and CUB CADET, a strong pipeline of innovation and customers and users who are eager for our newest products.

We remain focused on capturing that opportunity. We are rapidly making progress with our transformation. The organization remains committed to supporting the necessary cost efficiencies as we prioritize the additional investments in innovation, brand support and commercial resources that will be most impactful to reaccelerate growth and share gain in the market.

Now, turning to the Tools & Outdoor third quarter performance. Total revenue was \$3.4 billion, down 5% organically versus prior year as a result of lower consumer outdoor and DIY market demand. Our Tools SBUs in aggregate were positive organically in the quarter, excluding the Russia business exit, while Outdoor was down 23%, consistent with our expectations.

Price for the segment was down 2 points in the period, as we successfully regained margin-accretive cordless promotions, consistent with historical activity. We made substantial progress in improving adjusted operating margin to 9.3%. This was a sequential step-up of 480 basis points and 250 basis points better than last year. This improvement was driven by reduced sell-through of high-cost inventory, supply chain transformation savings and reduced shipping costs, which were partially offset by lower organic revenue.

In terms of performance by region, North America was down mid-single-digits organically. Similar to the overall segment, North America Tools organic growth was positive, while Outdoor declined. US retail point of sale for the quarter remained above pre-pandemic 2019 levels, supported by strength in professional demand and price.

Third quarter POS for DEWALT was positive versus last year, supported by promotions, our Pro inspired new product offerings and sustained professional demand.

Our European organic revenue was down 3%, with bright spots from double-digit organic growth in the UK and low single-digit growth in the Nordics. We are leveraging targeted programs to capture professional share with DEWALT Cordless Tools.

In emerging markets, we grew mid-single-digits organically, excluding the impact from the Russia business exit. Including this impact, organic sales declined 4%. Solid emerging markets performance was led by Latin America, which has now recorded four consecutive quarters of organic growth. We have seen notable strength in Brazil, particularly within the professional channels.

Moving to our strategic business unit performance, the hand tools business grew 2% organically versus prior year. This includes mid-single-digit organic growth in North America and Latin America, supported by expanded offerings at our retailers and strong new product sales.

Power tools declined 2% organically, pressured by consumer tools. Pro-driven momentum, coupled with positive impacts from a healthier supply chain, is supporting enhanced service levels and promotional opportunities.

Transitioning to Outdoor, organic revenue declined due to market demand choppiness as the industry resets from the pandemic era. This resulted in fewer shipments in the quarter as there are elevated inventory levels globally, impacting replenishment cycles.

Despite the current market environment, we are excited about the long-term opportunity in bringing leading innovation to Outdoor across our powerful brands. I want to thank the team for their strong execution in the quarter as we continue to focus on winning with our customers and capturing this amazing growth, margin and shareholder return opportunity.

Turning to the next slide. I would like now to highlight a few examples of how we are evolving our trade-focused offerings and cordless outdoor expansion. With professional tradespeople and end-user innovation top of mind, we recently launched the DEWALT 20-volt MAX 0.5-inch High Torque Impact Wrench. This is the industry's highest rated MAX torque cordless impact wrench in its class, ideal for use in heavy-duty applications. We also introduced the world's first battery charger box, the DEWALT TOUGHSYSTEM 2.0 Dual-Port Charger. Users now can protect, store and charge DEWALT batteries in a durable, weather-resistant container to keep professionals productive, despite rough job site conditions.

In Outdoor, as we gear up for winter, DEWALT has entered the snow category with the 60-volt MAX Single-Stage Snow Blower. Powered by two FLEXVOLT batteries, it is engineered to tackle tough demands and break down heavy, wet or packed snow. Our Pro Inspired innovation roadmap will continue to introduce solutions across our categories that enhance safety on the job site while elevating power and performance.

Now changing gears to DEWALT's new involvement with our social responsibility efforts, we are working to close the trade skills gap and shaping the future of construction technology in the electrical and plumbing trades.

In the third quarter, we opened the 2023 DEWALT Grow the Trades Grant and Trade Scholarship Program. These initiatives provide non-profits with the necessary resources to train, reskill and prepare tomorrow's tradespeople by directly supporting end-user trade education. This is a great example of our broader commitment to invest \$30 million to grow trade skills by 2027.

Now I'll turn the call back to Don.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

Thanks, Chris. I appreciate the energy and perspective that you have brought to the team, and I am excited to continue our company's strategic business transformation with you as a key leader on our strong management team.

Turning to the next slide, I would like to reinforce the focus areas across our company's transformation. One, streamlining and simplifying the organization, as well as shifting resources to prioritize investments that we believe have a positive and more direct impact for our end users and various channel customers.

Two, accelerating the operations and supply chain transformation to return adjusted gross margin to historical 35% plus levels, while improving fill rates to better match inventory with customer demand. Three, prioritizing cash flow generation and inventory optimization. And then four, continuing to advance innovation, electrification and global market penetration to achieve organic revenue growth of two to three times the market.

We believe this strategy will ensure our best-in-class product innovation is maintained while we continue to meet or exceed the expectations of our end users, and we dramatically improve the channel customer experience. In parallel, we will maximize cost opportunities within our control to fuel investments as we deliver our margin, earnings and cash flow goals.

As our margins expand, our focus is to accelerate share gains. We are prioritizing innovation and market activation investments across our powerful brands, and targeting the best prospects to maximize share gain growth and return.

We continue to benefit from being a simpler, more focused company across Tools & Outdoor and Industrial. And we expect over the next 12 to 18 months, we will find opportunities for further simplification across our businesses. As we evaluate where to invest and the best ways to maximize shareholder return, we will continue to take a pragmatic view of our portfolio of businesses. Our track record demonstrates we will act decisively when the time is right on those portfolio decisions.

I will now turn the call over to Pat, to share the latest progress updates on our transformation, financial insights on the quarter and our revised outlook for the year. Pat?

Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

Thank you, Don, and good morning, everyone. We continue to generate strong transformation results and go-forward momentum. Our cost reduction program delivered approximately \$215 million of pre-tax run rate cost savings in the quarter, bringing our aggregate savings to approximately \$875 million since program inception. This positions us well to deliver or slightly exceed our \$1 billion run rate savings target this year and to deliver \$2 billion run rate savings by 2025.

As it relates to the supply chain transformation, strategic sourcing initiatives remain the largest contributor to supply chain savings since program inception. The early actions focused on strategic components and logistics, as well as other areas. We have now covered approximately two-thirds of the targeted procurement spend,

establishing a carry-in savings trajectory consistent with that contemplated in the 2024 program target. Our supply chain management and engineering teams will continue to drive sourcing improvement through 2025 and beyond.

Activating our operations excellence program has also contributed significant savings this year. In the plants, where this has been activated, we are seeing increased productivity leveraging lean manufacturing principles. Our footprint-related projects are progressing on schedule with initial savings to begin this year.

As it relates to complexity reduction, our teams are assisting customers as they transition to replacement products with the goal of exiting 30,000 SKUs by the end of 2023. We are confident that our transformation can support the sustainable cost efficiency needed to return our adjusted gross margin to 35% or greater. These actions are creating the flexibility to fund additional organic growth investments in our core business.

Turning to our inventory reduction and gross margin improvement. We reduced inventory by approximately \$300 million, bringing our year-to-date progress to approximately \$880 million. The third quarter inventory reduction supported the generation of approximately \$360 million of free cash flow in the period, resulting in one of the strongest third quarter cash generations in the company's history. We have reduced inventory by \$1.7 billion since the middle of 2022. We achieved this through improved supply chain conditions, strategic inventory management and the planned production curtailments initiated during the back half of 2022.

We expect modest inventory improvement in the fourth quarter, which would bring our full year 2023 inventory reduction to at or near our 2023 objective of \$1 billion, as we prepare for next year's outdoor season and supply chain network changes. Inventory reduction will be a major contributor to our full year free cash flow target of \$600 million to \$900 million.

Looking to 2024 and beyond, we expect the additional multiyear inventory reduction opportunity to be at or above \$1 billion. We expect to pursue further inventory reduction at the pace of \$400 million to \$500 million per year. We will balance our goal of inventory efficiency with ensuring sufficient working capital to navigate through upcoming manufacturing and distribution network changes without impacting service to customers.

We remain focused on increasing profitability and working capital improvements to generate free cash flow. Our priority for capital deployment is to fund our long-standing commitment to return value to shareholders through cash dividends and to further strengthen our balance sheet.

Shifting to profitability. We recorded adjusted gross margin of 27.6%, up 290 basis points versus prior year and improving 400 basis points versus the second quarter. This is the third consecutive quarter that we delivered sequential gross margin improvement. Year-over-year expansion was driven by lower inventory destocking costs, supply chain transformation benefits and reduced shipping costs, all of which more than offset the impact of lower organic revenues.

Moving forward, we expect continued adjusted gross margin rate expansion, driven by the benefits of the supply chain transformation. Our guidance calls for adjusted gross margin to incrementally improve again in the fourth quarter.

Now that the high-cost inventory has turned through the P&L, we expect to continue to deliver expanding adjusted gross margin into the front half and full year 2024, supported by the success of our supply chain transformation.

Achieving adjusted gross margins approaching 28% in the third quarter was a significant milestone on our journey to restore 35-plus percent adjusted gross margin. The momentum of our supply chain transformation is translating

to sustainable upward progression in our margins and cash flow and will provide resources to fund investment to accelerate long-term organic revenue growth toward our goal of two to three times the market.

Now turning to our 2023 guidance. Our expected GAAP earnings per share range has been revised to negative \$1.45 to negative \$1 from negative \$1.25 to negative \$0.50, primarily related to the third quarter non-cash intangibles impairment charge of \$124 million.

GAAP earnings also include one-time charges primarily from the global supply chain transformation and Outdoor business integration. The current pre-tax estimate of acquisition-related and other charges is now \$425 million to \$450 million with approximately half of these expenses being non-cash.

Based on the strength of the third quarter, we are raising our full year adjusted earnings per share guidance range to \$1.10 to \$1.40 from a previous guidance range of \$0.70 to \$1.30. We delivered a strong third quarter cash performance and are maintaining our full year free cash flow target of \$600 million to \$900 million.

We expect fourth quarter cash flow to be supported by positive cash earnings, inventory reduction and the typical seasonal receivables reduction in Tools & Outdoor. The organic growth outlook for the year is unchanged with the total company expected to be down mid-single-digits. This implies a revenue midpoint of \$15.9 billion for the year, and includes estimated risks for auto strikes and continued infrastructure customer destocking.

Turning to important remaining elements of guidance. Our expectation is for production to continue to normalize in the fourth quarter. We remain disciplined and flexible in our approach to invest to drive organic growth and share gains. Our outlook assumes approximately \$125 million of annualized innovation and market activation investment with a goal to ultimately deploy \$300 million to \$500 million over the next three years.

We expect fourth quarter adjusted operating profit to approximate \$290 million with adjusted gross margin to sequentially improve to the 28% zone, both at the midpoint of our guidance. This continues the strong momentum from our cost reduction program while prioritizing strategic investments in the business.

With that, I will now pass the call back over to Don.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

Thank you, Pat. We are pleased to report another quarter of progress on our journey of transforming Stanley Black & Decker. Consistent successful execution against our plan gives us the confidence to increase investments, which will accelerate organic growth behind our most powerful brands.

As we continue to focus on what we can control to be successful, I am confident that we are creating a stronger and more focused company with our great people, amazing brands, and industry-leading end-user inspired innovation. We believe the outcome of our transformation will produce a sustainable market share gaining machine.

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

Dennis M. Lange

Vice President-Investor Relations, Stanley Black & Decker, Inc.

Great. Thanks, Don. Shannon, we can now start Q&A, please. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Julian Mitchell of Barclays. Your line is now open.

Julian Mitchell

Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. And great to hear that update from Chris on the momentum in the Tools business. Maybe my question, just around slide 9 and some of the commentary there on margins. So I guess, one is just it looks like the gross margin is up sequentially in Q4, but sort of operating margin down somewhat. So maybe just any sort of moving parts within that worth calling out?

And then you talk about the gross margin moving higher sequentially into the first half of next year. So maybe put that in context for us in terms of what does that tell us about the confidence in that sort of \$4 to \$5 of EPS number that you have mentioned in the past, there's perhaps some kind of framework for earnings next year? Thank you.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

Thanks for the long multiple questions there, Julian, but they're good questions because they're things that we're very focused on. As far as our margin rate improvement, we're really pleased with what occurred in Q3 and what we believe will play out in Q4. And I'm going to ask Pat to give us more color on your questions around margin. And then tying it into the \$4 to \$5 for next year, we still feel that that is a good range and potential outcome for us, and Pat will give little more color on that as well. Pat?

Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yes. Hey, Julian. Our focus is going to remain margins and cash generation until we're back to the operating model that the business has traditionally had.

I'd say gross margin, you saw both effects, the effects of the program driving the cost savings we expected to the tune of 100 to 150 basis points of margin improvement in the quarter. Deflation also helped in the quarter, mostly from shipping coming off the balance sheet of another 100 to 150 basis points. And then broader high-cost inventory coming off the balance sheet of around 300 basis points. And that was our expectation. It's great to see the teams working hard together to deliver the program on cadence. But as we had been telegraphing to investors, we could see the rate at which high-cost inventory was coming off the balance sheet, and that came well within our expectations and drove the important gross margin expansion.

From here, we have a pathway to 35%. Obviously, the pathway going forward, it's not going to be perfectly linear, but it's certainly going to be more in the range of 50 basis points to 100 basis points a quarter on gross margin.

As to your operating margin question, that had more to do with just – it was about 200-plus million less revenue in this quarter, and that was really the driver of the operating margin difference as we continue to invest in the business. And we're going to go forward, both in the fourth quarter and as we head into a dynamic 2024, focused on continued gross margin expansion and cash generation. We are going to be investing for growth. And that's part of what we're doing in the fourth quarter, and that's what we're going to plan to do in 2024 as well. But we'll be mindful of the macro environment and what that means for cash delivery and de-levering along that realm.

And the \$4 to \$5, I would say, given the performance of the business in the back half of the year in a dynamic market, I would still say we see the \$4 to \$5 as a reasonable range. Certainly, it's dependent on the macro and the deflation versus inflationary environment. I would say that the \$4 to \$5 anticipates a stable or improving macro. If you're at a stable side of the macro, you're probably on the lower side of the range. And if you're at an improving macro, you kind of go towards the higher side of that range.

Operator: Thank you. Our next question comes from the line of Tim Wojs with Baird. Your line is now open. Tim Wojs, your line is now open. Please check your mute button.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

We lost Tim.

Operator: Our next question comes from the line of Jeff Sprague with Vertical Research Partners. Your line is now open.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC

Q

Thank you. Good morning, everyone. And hello, Chris. Good to hear your voice again. I guess, this is maybe a little bit of a multi-parter also. But just kind of thinking about as you pivot from just kind of outright cost reduction to reinvesting for growth and the like, does all or most of this reinvestment happen inside of COGS and the gross margin discussion? How much of it ends up kind of in selling sales force, things that you're doing on kind of developing the trades that you mentioned?

And maybe just as part of that selling related question, maybe just a little bit more color on what you're seeing on promotion and just kind of the general pricing environment in the market. Thank you.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

Yeah. Jeff, I'll ask Chris to give a little more color on that. It clearly is going to be heavily weighted to SG&A and selling resources and activities. But let's give Chris an opportunity to give you a little more color on that, Chris?

Christopher J. Nelson

Chief Operating Officer, Executive Vice President, President-Tools & Outdoor, Stanley Black & Decker, Inc.

A

Yeah, Jeff, thanks a lot. It's nice hearing from you again. Yeah. What I would say is that per Don's comments, as we think about how we're going to move forward and I would say, have focused investments in the business, in the areas that we believe will drive the most leverage, making sure that we see which brands we want to invest in and what levers we want to pull there.

And obviously, we've seen the strength in the Pro and there was – we did, as far as near-term look, DEWALT was a positive story in the quarter. We need to keep on gathering steam with that.

What I'd say is that, as far as in the investment buckets, and where we're thinking we could have the most leverage, certainly having the right products for the professional end-user is a large emphasis for us.

We referenced a few of the launches that we have in the near-term, we are going to continue to double down on those types of investments for the Pro end-user because of the strength of the brand as well as what we see in the marketplace.

Similarly, we want to make sure that we have the right commercial resources in the right markets on the ground with our customers, working with them on ways that we can grow together, because we really think that there's some great opportunities in the area – in that area. So, that's where really, out of the gate, the emphasis is going to lie.

As far as your other question on where we see – what we saw on the promotional activities, we're – we did reference that we're going to be back and returning to traditional levels of promotion, and we did that in Q3. And it started our quarter out strong. And we're happy to be back in that promotional mindset, because it is an important part of the business, and we think it is healthy and accretive for the business going forward.

Now, we also are certainly going to supplement that with the new launches, and we're going to lean into the new launches going into the back half of the year to continue that growth. But all in all, we're seeing the – in Q3, our sell-through was in line with our expectations.

And as far as pricing, we see discipline in the marketplace as far as no deep discounting, and we're going to make sure and continue in our healthy and traditional promotional mix. But then, like I said, also be driving growth organically through leaning into the opportunities that we see with the Pro.

.....
Operator: Thank you. Our next question comes from the line of Michael Rehaut with JPMorgan. Your line is now open.

.....
Michael Rehaut

Analyst, JPMorgan Securities LLC

Q

Thanks. Good morning everyone. Appreciate it. I just wanted to kind of understand some of the puts and takes on the updated guidance, if I may. Kind of what really, in effect, drove the upside in the third quarter?

And it seems like on an EPS basis, you're, in effect, reiterating the implied fourth quarter guide. I think you referenced investing in growth. I don't know if that's something that maybe perhaps you're increasing in the fourth quarter relative to prior expectations. But would love to understand that dynamic of what drove the 3Q upside and why you're reiterating 4Q? And also, to that point, the reiteration of the free cash flow guidance relative to the raising of the EPS guidance, what's the bridge there as well? Thank you.

.....
Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. Mike, good morning. Third quarter was a strong quarter for us. Our sales came in roughly as we were expecting and we drove the EPS beat on the strength of gross margin performance and SG&A management. The gross margin is a factor of the program running a bit ahead of both pace and absolute dollar generation, and that drove strength in the quarter from a gross margin perspective. Our teams are managing SG&A thoughtfully in the macro environment.

Also, as Chris and team came on board and I spent part of the quarter kind of revisiting current and future year priorities, there was probably a bit of SG&A that will shift from the third quarter to the fourth quarter that helped out the third quarter net-net.

As we head into the fourth quarter, the top line is probably a bit softer, probably to the tune of around \$100-ish million or so versus the expectations we would have had a quarter ago. Most of that is baking in the trends in outdoors and attachment tools that we saw in the third quarter and also an expectation that unsettled UAW strike with at least two of the big auto manufacturers could pose some headwinds to our fastening business. So, a softness in the fourth quarter at the top line slightly is one of the reasons that the guidance in absolute terms in the fourth quarter is there.

And then we are investing, as I mentioned. Some will be a little bit of a shift of SG&A from the third quarter to the fourth quarter. But we're at a point where we're confident in our margin and cash generation trajectory, we need to start investing for growth, and we are doing that in the fourth quarter. And those two things, together, keep the EPS amount constant in the fourth quarter. And then on free cash flow, much of this year's free cash flow is generated by working capital dynamics. And much of those dynamics are continuing to play out according to plan and forecast. And that's largely why the free cash flow guide stays what it is for the year and the quarter.

Operator: Thank you. Our next question is from the line of Tim Wojs with Baird. Your line is now open. Tim Wojs, your line is open. Please check your mute button. Our next question comes from the line of Chris Snyder with UBS. Your line is now open.

Chris Snyder

Analyst, UBS Securities LLC

Q

Thank you. I wanted to just follow-up on the prior commentary of about 50 to 100 bps of quarterly gross margin improvement. And it seems that it would imply 2024 exiting up around 300 basis points year-on-year at the midpoint. So obviously, very strong growth next year. Can you just maybe talk a little bit about what that assumes from both a macro and volume standpoint and also from a cost [ph] interest (00:39:30) standpoint, I guess, metal and freight maybe? Thank you.

Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. We'll give detailed 2024 guidance at the end of the year when we do our fourth quarter. But I can point you in a few directions, especially around the gross margin because it's such an important point of our progress and where our focused energy is. I think on a full year basis, for 2024, we would expect full year gross margins around 30%, potentially a little bit higher than 30%. Obviously, that means exiting above 30% because we come in somewhere in the 28-ish range. And so I think you have it right. It is an exit rate that's going to be somewhere in the low-30s. We'll update to what degree that is in January.

I think when you talk about the macro, the macro while there's certainly a dynamic environment, it's probably given all that's going on in the world, held in a bit stronger than we would expect. And a lot of what's going in our business is kind of the resetting of inventories and channels this year, the resetting of the outdoor business post-COVID and a little bit of the shift that consumers have from buying goods to buying services.

And so I think the top line next year, we're expecting a similar stable-ish type macro environment with some dynamic elements around it. But it's really going to depend on our volume next year. It's really going to depend on has the consumer stabilized in the rebalance between goods and services and has the outdoor business stabilized post-COVID.

Operator: Thank you. Our next question comes from the line of Nigel Coe with Wolfe Research. Your line is now open.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Hi. Thanks. Good morning. Thanks for the question. It seems like everyone's getting in three or four questions into one question. I'll try and keep this a little bit simpler. But maybe not. Who knows. I was just thinking in a sort of flat macro given the inventory destock, especially in the attachments and obviously outdoor, even in a stable macro, do you think you can grow top line in that kind of setup?

And then maybe my follow-on question within the question is, what does the write-down at Irwin and Troy-Bilt tell us about those brands? I mean, is this part of the SKU reduction initiative? Any kind of like insights into what's driving those write-downs?

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

Yeah. I think the – I'll start with the brand question and navigate to the macro question related to next year and thoughts about could we grow our top line. The Irwin and Troy-Bilt brands that – are very good brands and they're outstanding brands in our portfolio. But as we have continued to focus on the simplification of our company, there's a lot of aspects of that. There's the aspects of how we do business with our customers and our suppliers, how we work internally in a more efficient and effective way. But there's also looking at the simplification of the brands we have and how we go-to-market and where we can effectively utilize them the most.

We clearly have three very powerful brands that are incredibly important to our strategy in DEWALT, CRAFTSMAN and STANLEY and those will be focal points for that strategy going forward. But as you get into the next tier of brands like Irwin or LENOX or Troy-Bilt, et cetera, we will utilize them effectively, but we'll utilize them in a more simplified way. And you're really seeing the impact of that with the adjustment to the valuation of what was on our balance sheet. It's really nothing more than that. There's a little bit of the SKU rationalization impact in there, but I think it's more of the strategic way we're going to utilize it going forward.

Looking at the macro for next year, I mean, I think Pat gave a really good answer as to our view is things are not – they're kind of mixed and it's dynamic. And that's the way it is today. And then we're kind of going into next year thinking it's going to be similar to that. We have pockets of strength like our professional tool business. We have weak points in outdoor and consumer trends. We got strength in aerospace, in auto, in our fastener and Industrial businesses. And we have some destocking happening in some other portions of our Industrial business that probably will be behind us as we go into next year.

So we think it's going to be mix like that throughout most of next year. Could things get worse? Possibly. Could things be better? Yes, that's possible, too. I think we're all watching the Fed to see what it does related to interest rates. If interest rates do not continue to rise, then I think we feel like there will be a stable environment that we can manage too that will be somewhat consistent to this. And if it is stable, can we grow? Well, we are investing for – the main objective and reason is to focus and gain market share. And we've had a long history of gaining market share at Stanley Black & Decker. And we went through a period of time, in particular, in late 2021 and 2022, where we felt the impact of the shortage of semiconductors that really put us in a position where we actually lost some market share.

And we've been pretty frank and clear about that. But we are positioning ourselves again to get back to gaining share. And we believe we've stabilized a lot of that at this stage. And these investments that Chris referred to, and

Pat in their commentary are things that we believe will allow us to grow above the market, whatever the market is. And if the market is negative, we won't [ph] be sliding (00:45:39) as much negative. If it's stable or neutral, we'll probably grow a little bit. And that's really the goal and objective that we're going after. And over time, we'd like to, as we've said, be able to say that we can grow somewhere between 2 to 3 times the market.

Operator: Thank you. Our next question comes from the line of Rob Wertheimer with Melius Research. Your line is now open.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Thank you. I'd actually like to start where you just ended on market share and trends there. And my question, I guess, specifically, there's been obviously a change in the mix of construction in North America where you have larger projects, mega projects, whatever, maybe housing's holding in there. I'm a little bit curious if there are any margin or market share or go-to-market impacts from that, maybe you have more Pro, maybe you have more high need, high reliability, maybe not. I'm just curious about whether that has any impact on your business? Thank you.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

Thanks, Rob. Yeah, I think we're probably over using the word dynamic, but I think it's an appropriate word to describe the current market situation because there's a lot of different shifts happening. There's certainly a great deal of construction activity, but it's shifted quite a bit from what it was 18, 24 months ago, where it was very heavily residential focused and commercial focused, to some extent, and then we went to the pandemic and the commercial activity slowed down.

So we continue to see different types of shifts. We do not see radical shifts in our business model though or how we go-to-market at this stage. One of the really great things about Stanley Black & Decker is that we have over the years been very focused on what are the right channels to the end user, the professional, that ultimately is the ones, the individual that use our tools. And because of that history and then those channels that we have a very strong presence in, in not only North America, but the European markets as well as emerging markets around the globe.

We have that presence to be able to ensure that we're meeting the need of the end user. And if the end user is shifting to e-commerce, we have the ability to serve them in e-commerce as well or if they continue to want to go to the traditional distributor that they've spent time with, we sell through that channel.

So I think we are positioned well for whatever may happen in the future. Clearly, there will be a shift – continued shift over time where more and more people focus on e-commerce activity. We positioned ourselves well over the last decade to be able to continue to address that.

I think you'll see more of that shifting as you get into some of these commercial and industrial channels with larger distributors as they've built some e-commerce platforms during the pandemic to deal with a period of time where people didn't want to get close to each other. And we've been able to adjust that as well. So we're going to continue to do that. It'll probably be an area that we will invest in over time to make sure that we meet those needs of the channel.

Operator: Thank you. Our next question comes from the line of Joe O'Dea with Wells Fargo. Your line is now open.

Joseph O'Dea

Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. Thanks for taking my question. I wanted to ask on the sort of returns targets around investment spend. And so when you think about investing \$125 million, how do you think about the returns there and tracking them? And so both from the market out growth as well as the evidence of that. So when you spend \$125 million, how do you go about tracking that it's actually achieving the targeted outcomes?

Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. Joe, what I would say is long-term we want to have very productive investments in SG&A. That's mostly where these investments we're talking to you are centered. And our long-term financial algorithm probably has SG&A somewhere around that 19-ish percent of net sales. And so long-term, every time we put \$1 into SG&A, you need to be getting more than five of those out of the top line at a gross margin that's at or above our fleet average. And that's certainly, as we go into these investments, very, very much the intent.

The pace at which that happens obviously can differ depending on where you are in your certain competitive dynamics and which investments you're making at a given point in time. But that's our financial algorithm. Right now, and maybe Chris may want to add some things to this, but our focus right now is on reenergizing the engineering and innovation engine and then reenergizing the activation around our pre-existing marketing investments and around that innovation. Those two together are probably 80% to 90% of the investment per spend that we're making. And it's all to get the growth of the biggest brands getting back to above market growth. I don't know if there's anything you want to add to that, Chris?

Christopher J. Nelson

Chief Operating Officer, Executive Vice President, President-Tools & Outdoor, Stanley Black & Decker, Inc.

A

No, I just think that the comment that Don made about the three flagship brands that we have, and it's not only about net incremental investment, but it's also taking a look and seeing how we can reallocate existing dollars towards those three priority brands and the key initiatives that we see with the Pro end user as well as making sure that we have the right commercial resources in place to be driving those returns as well. So we're thinking at looking at the entirety of the spend and not just the net incremental, and then driving that into measurable initiatives to be able to make sure that we're getting the types of returns above fleet average that Pat referenced.

Operator: Thank you. Our next question comes from the line of Nicole DeBlase with Deutsche Bank. Your line is now open

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Thanks, good morning, guys.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

Good morning.

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Q

Just wanted to ask one on pricing. So I think originally, you guys were kind of expecting flat to slightly down in the quarter for tools, obviously, a little bit weaker than that. Just maybe a little bit more color on this from a competitive perspective and your thought process on pricing into 4Q and perhaps thoughts around 2024? Thank you.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

Go ahead, Pat.

Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah, Nicole, purely from a guidance and actual perspective, I'd say very much within the bounds. I'd say the only dynamic that played out a bit differently in the quarter is the promotional mix around margin accretive. Power tools was a bit higher, which was net-net accretive to the P&L. You saw the gross margin performance in the quarter, just as you reconcile and provide out the actual color, and pricing was a little bit more than we would have expect. But I think that's kind of on the margin of just how promotional activity unfolds in the quarter. But I – and Chris may want to add to this, I don't think we see any kind of change to the competitive dynamics, inclusive of the pricing related to the competitive dynamics?

Christopher J. Nelson

Chief Operating Officer, Executive Vice President, President-Tools & Outdoor, Stanley Black & Decker, Inc.

A

No. As I said earlier, I think we see fairly good stability in the pricing and not a lot of competitive deep discounting. And our – just to reiterate, our focus is to be healthily involved in the promotional aspect of the business because we think it's important to have those key brands and products out in front of our end users and our customers, and we intend to continue at kind of those traditional levels. But more importantly, we are looking through our innovations and how we think about launching new products to be able to continue to supplement and grow those margins as well.

Operator: Thank you. Our next question comes from the line of Joe Ritchie with Goldman Sachs. Your line is now open.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Q

Thanks. Good morning, guys.

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

Good morning.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Q

So you talked about getting a normalized production in the fourth quarter. I'm curious, this maybe a two-part question, do you expect to stay at normalized production throughout 2024? And then as you kind of think about

maybe some of the onetime hits to your profitability in 2023, can you quantify whether it's the inventory piece, the production piece, how much does that help the bridge for 2024?

Donald Allan, Jr.

President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.

A

Yeah. I'll let Pat give a little more color on that, but we are pleased that we've gotten to a more stable manufacturing level here in the fourth quarter. And at this point, the view of next year is, if we assume the environment that Pat described around the \$4 to \$5 of EPS, that if we're in that range, because of where the macro is, we would expect it to continue to be stable. We will continue to focus on optimizing inventory next year. So Pat, maybe give a bit more color on that.

Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. I think, Joe, we certainly feel like we have opportunity to get inventory much leaner, right, probably to the tune of \$1 billion to \$1.5 billion over the next two to three years at a pace of \$400 million to \$500 million a year.

I think as it relates to the production normalization you asked about, and as it relates to kind of one-time items in the cost structure, I'd say for the most part 2024, we expect production to be normalized.

Obviously, as we and the rest of the Outdoor industry find the new kind of post-kick COVID outdoor base, we'll be mindful of the production levels in our Outdoor space, but that's kind of \$2 billion-ish of a \$13 billion, \$14 billion T&O business.

So I think those production schedules will be tied to the market realities we see in Outdoor. But broadly speaking, in this fourth quarter and as we head into 2024, Tools production has normalized.

I think as you talk about the one-time cost, those you're kind of seeing in our gross profit as we exit the fourth quarter of this year. So during this year, you've seen a cost of about 400 basis points in total, 300 basis points of which was roughly high-cost inventory and one of which – 100 basis points of which was kind of under absorption of fixed costs.

That has played out within 2023. And you're seeing that in the gross profit margin that almost hit 28% in the third quarter, and we'll probably be at or above in the fourth quarter. And so that's kind of behind us. And we're building off of that 28-plus percent gross margin next year, as we head into 2024 and the program continues.

Operator: Thank you. I would now like to hand the call back over to Dennis Lange, for closing remarks.

Dennis M. Lange

Vice President-Investor Relations, Stanley Black & Decker, Inc.

Shannon thanks. We'd like to thank everyone again for their time and participation on the call. Obviously, please contact me if you have further questions. Thank you.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2023 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.