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Stanley Black & Decker, Inc. (SWK)

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MANAGEMENT DISCUSSION SECTION

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Good morning. I'm Sam Darkatsh, on behalf of Raymond James. I would like to welcome you to the Stanley Black & Decker Presentation for today. With us from Stanley, Don Allan, President & Chief Executive Officer; Dennis Lange, Vice President of Investor Relations, Christina Francis, also Director of Investor Relations.

Don, I think, you mentioned maybe 20 minutes or so of prepared remarks, which should give us maybe five to seven minutes or so of Q&A here in the room. There will be a breakout session immediately following downstairs where we can get into more granular Q&A. And with that, Don, as always, welcome back.

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

Thank you, Sam. Good morning, everybody. So, as Sam said, I'd like to spend about 20 minutes and just go through about eight slides, I think, of the journey that we're on here at Stanley Black & Decker, since I became CEO a little more than 18 months ago. And as for those of you who are not as familiar with our company, we had two primary business, Tools & Outdoor business, which is very well known to most people with brands like DEWALT, CRAFTSMAN, STANLEY, CUB CADET and BLACK+DECKER. And then we have an Industrial business, which is primarily made up of an engineered fastening business that I can touch on in a little bit.

We announced the sale of our Infrastructure business in late stages of 2023 and hope that that will close here at the end of Q1 or early Q2, which will result in about $700 million of net cash after taxes.

So that's just part of some of the portfolio streamlining that we've been doing that I'll touch on in a few minutes. The revenue of the company last year was just under $16 billion. Our market cap, as you see, is close to $14 billion and we continue to pay a substantial dividend as it's an important part of the capital allocation strategy that we've had as a company and will continue to have going forward.

Core capabilities as you see on the slide, just iconic brands in particular in our Tools & Outdoor business, but also some really impressive brands in the industrial space, such as POP, which has been around for quite some time

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in Engineered Fastening. Powerful innovation engine. We believe that we are the industry leaders in innovation in both these particular businesses and continue to invest to make sure that we maintain that or improve upon it depending on the situation.

Great coverage across the geographies and the channels that we serve. One of the benefits of the significant amount of brands that we have, it gives us the opportunity to meet the needs of many channel customers as well as many geographies, and we think that's a competitive advantage. And then, we've put a heavy focus on operational excellence that I'll talk about in a few minutes as we have really been putting a ton of energy in transforming our supply chain over the last 18 months, and we still have another 18 to 24 months to go in that journey as well. So, we've been powered by great people and great innovation and great brands, and we continue to believe that's the thing that really uniquely differentiates us – ourselves as a company.

So, we've been transforming. As we went through the pandemic, many companies experienced demand bubbles and fluctuations, demand strains on the supply chain, et cetera. And as we came out of the pandemic and one of the things that I wanted to do when I became CEO is how do we really reduce the complexity of this company, really streamline the effectiveness of the portfolio and the operations? And I put it into the different categories that you see here on this page. One is, I do believe that our cost structure had gotten to a point around supply chain in particular, that we needed to become a lot more efficient. But the first thing we did was optimize our corporate structure. I think, the corporate structure was investing in areas that frankly didn't create a lot of value. And so therefore we made some changes and reduced costs there in a substantial way.

We focused our operating model and how do we become more efficient in meeting the needs of our customers and the end users that we serve? How do we continue to drive high levels of innovation and make sure that our service levels exceed the expectations of our customers? To do that, we needed to radically transform our supply chain. But I also felt like we needed to invest and taking out cost is something that you need to do to become more efficient and effective. But you also need to make sure you're investing in the right core growth opportunities. And we could invest more in innovation, more in electrification, and also more in what I call the field, which are really the resources that are out there that interact with our end users on a day to day and a week to week basis. And we needed to invest in our supply chain. We needed to make sure that we have the right tools and the processes and automation to ensure that we can meet the expectations of growth going forward. So we said we're going to take about $300 million to $500 million of those $2 billion of savings and reinvest in these particular areas or increase the investments in these particular areas. And I'll touch on that a little bit, like, more color later on.

I also believe that we have a business that has unique differentiation that allows us to grow organically 2 to 3 times the market, and we define the market as GDP. In the short term, the market can be defined as what happens with new home construction, repair and renovation, industrial manufacturing growth, et cetera. But over the long term, GDP actually is a good indicator of what happens in the markets that we serve. We want to get back to a 35% adjusted gross margin by 2025, and we've made substantial progress in that in 2023. But we still have a significant amount of work to do to get to that objective, get back to strong free cash flow, 100-plus-percent of conversion. I mentioned innovation, and I mentioned fill rate improvements. Our fill rates have improved dramatically in 2023, to the point now where we are meeting customers' expectations and we're migrating to a point now where hopefully we can exceed their expectations in the next 12 to 18 months.

So the progress so far in 2023, as I mentioned, we're very pleased with what we've been able to do in the last 12 to 18 months. We've been active in really managing the portfolio of businesses. I mentioned the infrastructure business. We also sold our oil and gas business a year, year and a half ago. We sold our security business a few years ago. So we continue to streamline our portfolio and really focus on the businesses that drive the most value

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for our shareholders, which is our Tools & Outdoor business and our Engineered Fastening business. And those are the businesses that we will continue to evaluate and do maybe a little bit more pruning, but relatively modest in size as we do that.

We've changed our leadership team. We brought in three new C-suite leaders. Chief Operating Officer, Chris Nelson came from Carrier; Patrick D. Hallinan, our CFO that came from Fortune Brands; and then John Lucas, who's our CHRO, who has worked as CHRO with Goodyear and Lockheed Martin. So seasoned individuals that have a lot of experience in transforming companies and building out the operating model that I want to achieve for this company.

Profitability improvement and gross margins, we sequentially had improvement in each quarter of last year. Our adjusted gross margin is approaching 30% in the fourth quarter. In the back half of last year, it was about 28.7% or just under 29%. So substantial improvement from where it was at the end of 2022. And then our free cash flow conversion, we converted about $1.9 billion in inventory over the last 18 months into cash, about $1.1 billion in 2023. And so we had a strong free cash flow performance of $853 million during 2023. So great traction in the first full year of this transformation, but still with a lot of opportunity in front of us. So this cost reduction program still has a lot of value. So we said $2 billion 18 months ago, we've already achieved $1 billion. So we have a $1 billion to go in 2024 and 2025. And it's pretty evenly split between those two years.

And I mentioned the things that we've done around the $2 billion on the left side of the slide. Our focus last year was really about strategic sourcing. How do we drive more value with our vendor base? How do we consolidate our vendor base in certain areas and really reduce the tail of suppliers or vendors that we have to maximize the value opportunity? And a large part of our transformation value that we saw in cost of sales came from this initiative in 2023. We've also focused on operations excellence, which is getting more and more lean activities into our plant system that's consistently driving more efficiency and effectiveness in all of our plants across the globe. We began to accelerate that in 2023 and we'll continue to invest in that in 2024 and 2025.

Footprint – footprint rationalization is an area that we started in 2023, but we'll be doing more of that in 2024 and 2025 as we reduced the number of plants across the globe for Stanley Black & Decker. We will continue to accelerate that here in 2024. And we see significant opportunities not only in rationalizing the plant system, but also looking at our distribution network in the United States. So it better serves our customers and achieves the fill rate objectives they have of being in the high 90 percentile.

And then the last thing, but certainly not least, is complexity reduction. So that's really twofold. One is just generally looking at SKU rationalization and SKU reduction, which we did a lot of that over the last 18 months for things that don't have a lot of revenue tied to them and we took out, you know, 20,000, 30,000 SKUs from our system with really minimal impact on our revenue. The next phase of this is really more focused on what we call platforming, which is taking various product families and looking at them and say, how do I make certain parts and components standardize across this product family, where 60% to 70% of those parts and components are similar across that product family. And then the 30%, 40% is where you kind of uniquely identify with a DEWALT brand some special functionality that you don't have in a CRAFTSMAN brand or a STANLEY brand. And that is something we've done in parts of our company. But we need to really apply that in a significant way across our power tool business in particular. And we do think that will be a large value driver for us to help us achieve this $1 billion over the next few years. So the program continues to be on track and it is allowing us to fund and fuel some of the investments that we want to make to get back to gaining market share as a company.

As I mentioned, we're looking at $300 million to $500 million of investment. We've made about $125 million of that last year. And right now we're planning to do about $100 million more in 2024. So close to two-thirds of the low

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end of that range. The initial focus has been more around engineers and innovation and getting more targeted around certain product families where we can drive higher levels of innovation, in particular in the power tools and outdoor space. Electrification continues to be an important part of our innovation strategy. It's not only just electrifying our outdoor products from gas to battery, it's also looking at a variety of different handheld products that exist in power tools and handheld outdoor that are currently either corded or driven by gas and converting them to battery technology over the next several years. There's still a substantial innovation opportunity in that particular area.

And then I talked about the other areas of market leadership and then really being more responsive with our supply chain and meeting the needs of our customers. We launched a DEWALT POWERSHIFT, which is basically a groundbreaking concrete equipment system that is driven by battery packs. And it's something that eliminates gas powered pieces of equipment or corded power pieces of equipment today. And it was launched at the World of Concrete in January of this year in Las Vegas. And we think this is a great example of the innovation that we continue to bring to the market.

We have said from the beginning of this transformation, we want to get closer to our end users. We want to be able to make sure that we're meeting the needs that they have with the innovation that we bring to the market. There's two different categories of innovation. There's innovation for an end user that makes them more productive, more efficient, more effective. And then there's innovation that some of our customers channel partners want to drive certain foot traffic and demand in their particular stores. Both of those are important. But we never should lose sight of the end user innovation because ultimately the end user is really what drives the demand over the mid-term and the long term. And so we're beginning to invest in field service resources that are out interacting with the end users on a regular basis. We've always had these resources in the field, but we're putting more resources out there because it does a couple things. One, it educates the end user on the innovation that we're bringing to the market and how it differentiates – how we differentiate ourselves versus our competitive set of products. It also helps us understand what needs we might not be meeting with our end users and how that might affect our innovation engine going forward.

As I said, we've always invested in this area, but we think we need to be investing more going forward as we continue to drive this operating model along the lines I described. And ultimately, that is, we believe that innovation with these brands is really what drives significant shareholder value over the mid-term and the long term.

So to summarize, I mean, we've become a much stronger organization, a more focused enterprise as we've rationalized our portfolio of businesses, rationalized our portfolio of products. We have a core set of brands in DEWALT, STANLEY and CRAFTSMAN in particular in our Tools & Outdoor business that can drive and have driven significant value and market share gain over the long term. It can also be the case going forward. They need to be supported by a continued strong innovation machine that we've invested in over the last several, several, several decades, and we'll continue to do that going forward. But examples of what we did at the World of Concrete are examples of things that we need to continue to do across multiple product families. And I feel very good about the funnel of innovation that's coming to the market over the next two to three years. And I think the example of the concrete applications is exactly the type of thing that you're going to continue to see from us that meets the need of end users as we electrify our products across many different categories, which is why I think, we have the opportunity to outpace the market by 2 to 3 times. And I define what – I defined what the market was earlier.

Also, the gross margin story continues to be an important story for us. We, as I said, made a great deal of progress in 2023. But we're not where we want to be. We want to be at 35-plus-percent. And so if you assume our

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exit rate was close to 30% in 2023, we still have 500 basis points to go. And the good news is we have $1 billion of opportunity in front of us, and that's in a market where you are not seeing a lot of growth right now in the market.

So this year, our view that we've provided guidance is that probably a relatively flat market to slightly down market, which is consistent with what we heard from some of our big channel customers over the last two weeks and what their view is. As the market recovers and it will because we are tied to an industry primarily, which is housing and construction, and that's going to be a strong market over the long term as we look at housing shortages across this country and other parts of the world. We will continue to see probably an interest rate environment that's a little bit choppy in the short term, but eventually will probably stabilize with some interest rate reductions later here in 2023 – I'm sorry, in 2024, that will help stimulate more activity and demand in the housing market and ultimately new home construction.

So to summarize, we believe these metrics on the left are achievable. We've made great progress toward that in 2023. Still have a lot to do in 2024 and 2025 to hit them. And we believe we have the amazing brands, as I mentioned, that allow us to achieve that outcome. We have end user innovation that continues to be rolled into the marketplace with a great funnel, as I mentioned, in front of us. And we have a wonderful team of people that feel empowered in their ability to be successful, to help us achieve the shareholder returns that we're looking for. We think we can drive long-term shareholder value through sustainable growth, higher levels of profitability and consistent cash flow performance.

So that wraps up my presentation. And I guess, I'm one minute early, Sam.

QUESTION AND ANSWER SECTION

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Perfect. So yeah, we've got like maybe 7 or 8 minutes for questions from the room. Anyone here want to start up, yeah?

Q

I really appreciate you targeting gross margins up to 35%. How much of that flows through to the bottom line, like EBIT, and then [indiscernible] (00:18:45)?

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

A

Yeah. So the question is appreciates getting our gross margins up to 35-plus-percent. How does that kind of flow through to EBIT or what we call operating margin rate percentage? And, I think, we believe with 35-plus-percent, our operating margin rate should be in the mid-teens. And so that means the SG&A investment is probably around 20% to 22% depending on a given year, which means you're probably somewhere between 13% to 16% operating margin. My sense is it's probably somewhere between 14% and 16% operating margin.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

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Other questions. You talked about these early trends domestically. What are you seeing around the world in both Europe and emerging markets? And then follow up question to that we're in first week of March, so we're getting close to the outdoor season. Any early indications of order trends or at least POS, since we may not see much order trends as they work their inventories lower, but just any sense of what we're seeing early on in the season?

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

A

The international markets have actually performed pretty much in line with our expectations so far this year. You're seeing growth in certain countries in emerging markets as expected. The European market actually has been pretty stable and in line with our view, some of those product families are up, a few of them are down year-over-year. And so, start to the year on an international basis has been pleasing and right in line with our expectations. North America, I think, continues to be choppy. The consumer market in retail is still relatively weak like it was as we ended last year. The professional construction market continues to be strong. So, last year our DEWALT performance for the full year was, up about 1% year-over-year, which actually we believe the market was down. So, we actually think that we might have gained some share in that particular space. And we think that those trends have continued here in 2024 for the pro, which is good. The outdoor market, it's too early to know at this point, Sam. There's some indicators that indicate that the start is good at this stage, but it's just too early to know at this stage. I mean, obviously the weather helps us where we've had more warm weather than cold weather in the northern parts of the United States, which usually means spring starts early, which is always a good thing for that business.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Other questions here from the room. So talk about your gross margin goals are just saying, hey, low 30s, end of the year, 35%, next couple, two, three years or so. If you beat or miss those particular targets, what were the primary reasons or variables that are the key drivers to performance?

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

A

Yeah, I think, it's the macro environment are probably the biggest wildcard. The $1 billion of cost takeout. I actually feel very good about our ability to get that cost out. Then it's a question of is the macro environments still choppy for the full year of 2024 and then also for parts of 2025? I think that's a bit of a wildcard that could maybe limit our ability to get to that 35%. Now, the opposite is true, too. I mean, you could actually see a market that's stronger in the back half of 2024 and stronger in 2025 that allows us to get to the 35% at a quicker pace and maybe even exceed it by the end of 2025. I think that's the biggest wildcard right now. The US presidential election is obviously a wildcard, depending on who wins that. We have an existing tariff regime that does impact about $100 million of cost for us currently today that we offset with price. If that regime changed under Trump as the President, that would be something we'd have to respond to with price actions and increases that could temporarily put us off track to what we're trying to achieve with gross margins.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

One of the primary pushbacks I hear from investors is that when comparing your investment spend to your primary competitor in Hong Kong, that it's significantly lower in both R&D and store level sales support. Thoughts in terms of either matching their levels or what the optimal level is for growth in investment. I know you indicated $100 million more this year...

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Donald Allan, Jr.
President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.
A

Yeah.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.
Q

– but ideally, what's the right number once the macro improves and the balance sheet is where you want it to be and the inventory is where you want it to be, that sort of thing?

Donald Allan, Jr.
President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.
A

I think, the – when I look at R&D, we tend to look at it as a percentage of revenue and if you look at our history, it's ranged anywhere from like 1.7% to 2.3% or 2.4%, maybe even 2.5% occasionally. I think, it should be around the 2.5% going forward. Last year it was closer to 2.3%, 2.4%. I think as we continue to make these investments, we're going to get to 2.5% and maybe slightly above that. And I think that's where we need to maintain it over the long term. Now we'll see if we get back to higher levels of growth does it drift down a little bit from that? Maybe it's down to 2.3% to 2.4%, possibly. But I actually think that's the right level of investment based on the needs for innovation around electrification, the needs that we're going to have in certain parts of the portfolio for outdoor, that we have to be spending at those particular levels on a consistent basis to make that sustainable.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.
Q

Store level sales support, same question.

Donald Allan, Jr.
President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.
A

Yeah, I think store level sales support, we will probably never match the one competitor because they do it in every single store. What we are doing and we'll continue to do is be more focused on the higher volume stores in both the case of our two major customers versus saying we're going to cover every single store. So I think, our models will always be a little bit different in that regard because that's where we think we create the most value.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.
Q

In your 10-K filing you break out your sales by customer and it looked like your performance at Lowe's was a little bit less than that of Home Depot. What was the driver there? Just your mix of outdoor through Lowe's or is there something else going on in the – at the tool crib between the retailers that affected the differentials in the growth rates?

Donald Allan, Jr.
President, Chief Executive Officer & Director, Stanley Black & Decker, Inc.
A

Well, the bigger – the biggest thing between those two customers is that if you look at Lowe's, they have a higher percentage of foot traffic that's tied to consumer versus pro and Home Depot has a higher pro buyer versus consumer. And so if you think about the commentary I was mentioning earlier that the consumer has definitely slowed their spending, some of that might be post-pandemic bubble, some of that might just be less confidence in the economy here in the United States. But the pro spend continues to be healthy and strong. And so that's really the main driver of why those two are different.

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Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

You've been paring off some lesser core, non-core businesses over the past couple, two, three years or so. As you look at the portfolio now versus ideally where you'd like to be two, three years, are there other areas where there might be opportunity for additional streamlining of things?

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

A

There are, but I think, they'll be relatively modest. You know as we look at our Engineered Fastening business now that we've – we sold the infrastructure piece, so Industrial is just Engineered Fastening. There's pieces in Engineered Fastening that we probably will prune off. And then when I look at the Tools & Outdoor business, there's a few non-core Tools & Outdoor businesses that we probably will prune off as well. None of these are substantial in size, and they'll probably tend to be anywhere from $100 million to $250 million in revenue on an annualized basis. But they – like anything when you have a portfolio – like, we ran into this before, we have a portfolio of businesses you had too many mouths to feed from a capital allocation point of view, so you had to kind of prune it so you could really focus your energy on the primary core businesses that drive the most value, in our case Tools & Outdoor and Engineered Fastening. The same is now true when you look at those two businesses, say okay, there's a few small pieces in here that just you're not going to have enough capital to allocate to them. So they're probably better off being in someone else's ownership.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

And with that, we're out of time. So we'll continue this in the breakout session downstairs. Thank you.

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

Thank you, everybody. Thanks, Sam.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Thank you.

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