REFINITIV STREETEVENTS

EDITED TRANSCRIPT

SWK.N - Q1 2023 Stanley Black & Decker Inc Earnings Call

EVENT DATE/TIME: MAY 04, 2023 / 12:00PM GMT

CORPORATE PARTICIPANTS

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

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

Patrick D. Hallinan *Stanley Black & Decker, Inc. - Executive VP & CFO*

CONFERENCE CALL PARTICIPANTS

Christopher M. Snyder *UBS Investment Bank, Research Division - Analyst*

Eric Bosshard *Cleveland Research Company LLC - Co-Founder, CEO, Co-Director of Research & Senior Research Analyst*

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

Julian C.H. Mitchell *Barclays Bank PLC, Research Division - Research Analyst*

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

Nigel Edward Coe *Wolfe Research, LLC - MD & Senior Research Analyst*

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

PRESENTATION

Operator

Welcome to the First Quarter 2023 Stanley Black & Decker Earnings Conference Call. My name is Shannon, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded.

I will now turn the call over to the Vice President of Investor Relations, Dennis Lange. Mr. Lange, you may begin.

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

Thank you, Shannon. Good morning, everyone, and thanks for joining us for Stanley Black & Decker's 2023 first quarter webcast. the webcast, in addition to myself, Don Allen, President and CEO; and Pat Hallinan, Executive Vice President and CFO.

Our earnings release, which was issued earlier this morning and the 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 a.m. today.

This morning, Don and Pat will review our 2023 first quarter results and various other matters followed by a Q&A session. Consistent with prior webcast, 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 actual results may materially differ from any forward-looking statements that we might make today. We direct you to the cautionary statements in the 8-K that we filed with our press release and in our most recent '34 Act filing.

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

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

Thank you, Dennis, and good morning, everyone. Before we begin, I am extremely pleased to have Patrick Hallinan on board and joining our call today at Stanley Black & Decker's newly appointed Chief Financial Officer. Pat brings to the team a deep track record of delivering business performance, growth and value creation and complex competitive consumer branded businesses.

Following my remarks, Pat will take you through the financial highlights as well as our current outlook. Welcome, Pat.

Earlier this week, we also announced that Chris Nelson will be joining the company in mid-June as Chief Operating Officer and Executive Vice President and President of Tools & Outdoor. Chris is an experienced global leader with exceptional industry knowledge and existing relationships with many of our customers. His track record of success implementing growth strategies, which have delivered customer-centric innovation and profitable market share expansion, make him the ideal leader for our tools and outdoor business.

I look forward to partnering with Pat, Chris and the entire leadership team to streamline and optimize the company around our core businesses and strong portfolio of global brands, as we execute our strategy and generate sustainable growth.

In terms of our Q1 performance, we continue to build momentum and make strong progress as the organization remains focused on our business transformation plan. We took additional steps forward in the quarter to better serve our customers and deliver for key stakeholders by reducing inventory, leveraging enhanced cost controls and optimizing our global supply chain, while continuing to increase our investments in innovation and end user activation.

The global cost reduction program delivered $230 million in pretax run rate savings this quarter, which is modestly ahead of plan. Since we launched the program, we've captured a total of $430 million of annualized savings. This is a great start, and we believe we are on track to achieve the expected $1 billion of total program run rate savings by year-end.

Inventory reduction is also ahead of plan, with an incremental $200 million improvement in the quarter. Even while we strategically build inventory in some categories to prepare for the upcoming outdoor and Father's Day merchandising season, we have now reduced approximately $1 billion of inventory since mid-2022. I'm encouraged by our progress thus far, and I am confident that by executing our strategy, we are positioning the company for a strong long-term growth, cash flow generation, profitability and shareholder return.

Our first quarter revenue of $3.9 billion was in line with Q4 2022. This was down versus prior year as price realization and solid industrial and professional construction demand was more than offset by lower consumer and DIY volume, currency and the oil and gas business divestiture.

Let me now provide some perspective on end market demand. The U.S. retail point of sale for our tools and outdoor products remained in a growth position this quarter versus 2019 levels, bolstered by price and healthy (inaudible). The outdoor season had a slow start in March, but April weekly point-of-sale trends have been encouraging.

Adjusted gross margin for the quarter was 23.1%, up 360 basis points sequentially versus Q4 2022. While there still is more work to be done, we are seeing adjusted gross margin improved, as destocking impacts moderate.

Adjusted EPS for the period was a loss of $0.41, significantly impacted by our planned prioritization efforts around inventory reduction. We are committed to advancing our business transformation plan and continuing our journey forward with persistent focus on what is within our control.

We are monitoring the demand environment and global economic dynamics and planning for a range of outcomes, which balance the potential continuation of the current trends with the possibility of improvement as well as the prospect of a further demand slowdown. We have planned for all 3 of these scenarios, and we'll respond accordingly if we see current trends shift.

We are reiterating our 2023 full year adjusted diluted EPS guidance range of $0 to $2 as well as our free cash flow guidance of $500 million to $1 billion. Pat will provide more color on this later in our presentation.

As we generate cost savings, we are continuing to make strategic investment in iconic brands, innovation engine, electrification and commercialization activation to position the business for sustainable growth and margin expansion. This includes hiring additional engineers focused on product platforming, electrification and innovation as well as feet on the street to elevate user activation activities, which will ensure we extend the leadership positions of these iconic brands.

Our priorities in 2023 remain unchanged: one, strong focus on cash flow through inventory reduction to assist with ongoing debt deleveraging; two, sequential improvement in our adjusted gross margin as we drive further supply chain transformation initiatives; three, get back to gaining market share in all major categories of our tools and outdoor business.

Successfully executing these priorities will result in a stronger balance sheet and significantly improved EBITDA in the second half of 2023 as we head into 2024.

Now let me walk through the details of our business segment performance. Beginning with Tools & Outdoor, revenue was $3.3 billion, a decline of 13% as price realization was more than offset by a decline in volume and a negative impact from currency. Volume was impacted by lower consumer and DIY market demand, modestly reduced channel inventory and a slow start to the retail outdoor season due to a cold March, with temperatures well below the 5-year average.

Tools & Outdoor adjusted operating margin was 3%, down versus the prior year, as price realization was more than offset by inflation, higher supply chain costs, production curtailments and lower volume.

North America and Europe were both down 12% organically, as both regions were impacted by the factors covered for the overall segment. Emerging markets were down 2% organically, but excluding the impacts from our Russian business exit, the region had 6% organic growth. This was led by strength in Brazil, China and the Middle East.

Moving to our strategic business unit performance, power tools and hand tools were primarily impacted by softer consumer demand, declining organically 12% and 6%, respectively. The outdoor business declined 16% organically, largely impacted by softer consumer demand and the cooler weather.

The slow start to the season pressured our outdoor results versus planned by approximately 5 to 6 points. We are monitoring demand to determine if this could potentially be recaptured in 2023, with encouraging POS in recent weeks signaling the season is now ramping up.

A key growth area for outdoor is leveraging the 2,500 pro dealers that we acquired with our acquisitions. This channel delivered a strong performance in the quarter and was up double digits year-over-year. Pro products under our Cub Cadet and Hussle Brands had a solid start, and we are building traction with our DEWALT cordless handheld products across the dealer network.

Now shifting to our industrial business, which had 3% organic growth in the quarter, with double-digit operating margin. Total segment revenue declined 5% versus 2022 as price realization was more than offset by last year's oil and gas divestiture, currency and volume.

The team leveraged price realization and productivity to deliver adjusted operating margin of 11%, up 410 basis points versus the prior year. Within the segment, Engineered Fastening organic revenues were up 3% led by aerospace growth to 30% and auto growth of 7%, offset by softer industrial markets.

Attachment Tools organic revenue were up 5% driven by strategic pricing actions and continued conversion of this business' significant backlog.

In summary, this was a job well done across the board by our team. We continue to reduce inventory and drove improved gross margins in a mixed revenue environment. My thanks to the entire team as we maintained our focus on the right areas, and we are seeing the results of our efforts.

On the next slide, I would like to review our long-term strategy that we launched last July as we transformed Stanley Black & Decker to drive consistent organic growth at accelerated levels well above market growth. Our teams around the world are gaining traction and executing on our primary areas of focus: 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 customers and end users; two, accelerating the operations and supply chain transformation to return adjusted gross margins 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 four, continuing to advance innovation, electrification and global market penetration to achieve organic growth of 2 to 3x the market.

Our business transformation remains on track to deliver on these financial commitments as we strive to elevate our customer and end user experiences to world-class levels. The streamlining of our company and the supply chain initiatives are tracking to expectations and continuing to gain momentum. The 4 value creation streams within our supply chain transformation strategy are advancing, with meaningful strides forward and $110 million of savings achieved in the first quarter.

Our global team is activating against our strategy with speed. The energy and passion is evident. And I'd like to extend my sincere thanks to our operations associates across the globe. We have made so much progress in the last 9 months, and every completed milestone is contributing to our shared vision for the supply chain of the future.

Now a few updates in this particular area. Within the SKU rationalization and product platforming value stream, we have approved the reduction of 60,000 SKUs across the portfolio, of which 16,000 are now decommissioned. The remaining balance is no longer being manufactured, and we are working with our customers to transition to new SKUs in the coming quarters.

Strategic sourcing has been a strong contributor to savings as we complete the $2 billion first tranche of spend assessment. We are on track to achieve the targeted savings. Our supply base will include both existing and new vendors, with a deliberate intent to improve geographic diversification and consolidation.

Our dedicated team is capturing cost savings, while deploying new processes to ensure sourcing changes are executed successfully. Our initial announcements related to the manufacturing footprint optimization were made in March, which includes site expansion, transformations into manufacturing centers of excellence as well as site consolidation.

We are on track with our expectations and are taking a holistic approach to our manufacturing base and logistics network to ensure we optimize the efficiency and utilization of our asset base.

Finally, we are increasing our focus on manufacturing excellence and reemphasizing the SBD operating model, along with lean manufacturing practices at our factories. We deployed this playbook at 4 plants in the first quarter. And in March, we kicked off at 9 additional sites.

We are seeing strong traction and are capturing improved productivity efficiencies where these tools were activated. We are excited with the progress, and you can expect us to continue to make strides in the coming months and quarters.

Turning to SG&A. We captured approximately $120 million of savings this quarter and are on pace for $500 million of pretax savings by the end of the year from simplifying the corporate structure, streamlining leadership spans of control and organizational layers, and reducing indirect spend.

We are confident in our ability to capture $1 billion of run rate savings by the end of 2023 and $2 billion of annualized savings by 2025 from this program.

A key tenet of our strategy is the acceleration of investment in innovation and electrification. We are making deliberate strategic investments to maintain our market-leading innovation ecosystem. A couple of highlights from this year's outdoor season.

In terms of delivering innovative cordless products, the Craftsman 20-volt lineup is designed for extended run time and better performance. This includes the new brushless string trimmer that is lighter weight than its gas-powered equivalent and carries more run time and force than prior generation.

The new cordless pressure washer also joins this lineup, in addition to the range of other new 20-volt cordless lawn and garden tools. Continuing to expand our 20-volt system is enabling users to go wherever the work is without the limitation of cords or gas engines. These items are currently available for this season, and we are excited about the initial market reception.

Additionally, we just received notice that we won 8 2023 Popular Mechanics Yard and Garden best new product awards across DEWALT Craftsman and Black & Decker. In addition to the Craftsman offerings just highlighted, the DEWALT Pruning saw and string trimmer were awarded as Best for Contractors and the Black & Decker pruning chain saw was named Best for light duty use.

This is a great recognition of the quality of the innovation we bring to the market and our ability to serve our entire user base from the consumer to the most demanding Pro.

Let me now turn the call over to Pat for some further financial highlights on the quarter and our latest outlook.

Patrick D. Hallinan - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Thank you, Don, and good morning to everyone. I'm honored to join Stanley Black & Decker, the worldwide leader in tools and outdoor at such a pivotal moment in the company's history. I have tremendous respect for the leadership team and Stanley Black & Decker's iconic portfolio of professional and consumer brands.

During my initial weeks, I have been impressed with the breadth and depth of the company-wide transformation underway, observing the early traction of the multiyear program and the savings captured during the initial phases. It is clear that the company's transformation is progressing rapidly and powerfully. I am energized to help accelerate the company's journey forward and to enhance our long legacy of market-leading innovation and profit performance.

Now let me walk through the details of the company's progress towards reducing inventory and improving gross margins. We exited last year with $5.9 billion of inventory. We reduced this by over $200 million in the first quarter. Since mid-2022, we have successfully reduced inventory by approximately $1 billion.

This achievement was driven by improved supply chain conditions and planned production curtailments instituted during the back half of '22 and which continue today. The targeted inventory reduction helped minimize the magnitude of the seasonal working capital build typical of our first quarter.

As a frame of reference, our first quarter working capital build has averaged $700 million over the last 5 years, while this quarter, it was $200 million, improving our cash performance primarily via inventory reductions.

We are on track to achieve our expected $500 million of first half inventory reduction as we work down raw material and component inventory, while selling out finished goods.

Our full year 2023 inventory reduction target remains $750 million to $1 billion, to drive significant cash flow generation and to pay down debt, strengthen our balance sheet and back our long-standing commitment to return value to shareholders through cash dividends.

Overall, the pace of our inventory reduction will be demand dependent. And in a few moments, I will cover the range of demand scenarios we are considering within our 2023 guidance.

Turning to gross margins, which are also improving in a manner consistent with our plan. First quarter adjusted gross margins were approximately 23%, up 360 basis points sequentially versus the fourth quarter 2022, as we saw a smaller headwind from destocking actions and as our transformation initiatives provide a greater income statement benefit, something we expect to continue.

Production curtailments in the first quarter were at levels relatively similar to those in the back half of last year, and the destock impacted gross margin by approximately 400 to 500 basis points. We expect a similar impact to the second quarter, resulting in second quarter adjusted gross margin consistent with that of the first quarter.

Our base case guidance anticipates the adverse margin impact from our targeted production curtailments and destocking will ease through the year, supporting adjusted gross margin expansion into the mid- to high 20s for the second half of the year.

The timing of normalized production and improved gross margin could shift earlier or later, depending on the demand environment and corresponding speed of inventory reduction. We will actively monitor demand and adjust our supply chain to optimize the pace of margin improvement and inventory reduction throughout 2023.

An important leading indicator for gross margin is the $110 million of supply chain transformation savings delivered in the first quarter. As these savings turn through inventory later this year, gross margin will expand further. It is encouraging to see the initial progress towards our multiyear target to return adjusted gross margins to the 35-plus percent range.

We are prioritizing cash generation, gross margin improvement and balance sheet strength. By executing against these priorities, we are positioning the company for long-term growth and value creation.

Now turning to 2023 guidance. We are reiterating our full year adjusted earnings per share guidance range of $0 to $2 per share. On a GAAP basis, we expect the earnings range per share to be negative $1.65 to $0.60, inclusive of onetime charges primarily from the global supply chain transformation and outdoor integration.

The current pretax charges estimate was narrowed to $275 million to $325 million, with approximately 25% of these expenses being noncash. We continue to target free cash flow generation of $500 million to $1 billion primarily driven by inventory reduction.

Consistent with the framework shared in February, we planned and continue to forecast around 3 2023 demand scenarios as the macroeconomic outlook remains dynamic. Our base case scenario assumes a modestly unfavorable market demand environment compared to what we experienced during the second half of last year.

In this scenario, we are assuming total organic growth to be down low to mid-single digits, incorporating the softer start to the outdoor season. Tools & Outdoor total organic revenue is expected to be down low to mid-single digits, while we expect low single-digit growth for industrial. The base case also assumes that we maintain the production curtailments with the intention to return to normalized production levels during the third quarter.

As a result, the under absorption of fixed manufacturing costs would continue to constrain second quarter operating margins to low single digits. As production returns to normalized levels in the back half of the year, we expect operating margin to improve to the mid- to high single-digit range, resulting in full year operating margins in the mid-single digits.

Finally, the base case includes approximately $125 million of annualized reinvestment targeting Tools & Outdoor growth acceleration and complexity reduction. We plan to be measured with the magnitude and timing of such investments, depending on the demand environment.

The second half acceleration scenario contemplates a stronger demand environment, supporting organic growth in the second half of 2023. In this scenario, we would expect a quicker normalization of inventory levels and gross margin improvement. Total organic growth would be relatively flat for the year. This scenario would position the company to deliver high single-digit operating margins in the second half as well as a larger level of reinvestment to accelerate our transformation.

The downside case reflects a deceleration of demand due to elevated recessionary pressures. If this scenario becomes the macro reality, we would expect full year organic revenues to decline by mid-single digits, with volume declines in both the Tools & Outdoor and industrial segments. In this scenario, production curtailments would likely remain in place through the end of 2023, extending the time line of our gross margin recovery.

With lower demand, we would adjust the level of reinvestment in CapEx until we have more clarity on the extent and duration of the macro impacts. We believe it is prudent to maintain these ranges of 2023 demand outcomes, production levels and approaches to reinvestment as we prioritize our transformation and inventory reduction and cash generation.

Turning to important remaining elements of guidance. For the full year, we expect the below-the-line expenses in total to be relatively similar to the guidance issued in early February. We are building an expectation for higher interest expense, which is offset by a modestly lower 2023 tax expense assumption.

For the second quarter, we are expecting a sequential improvement in operating profit primarily from seasonally higher levels of revenue. Adjusted gross margin is planned to be in the low 20s, relatively similar to that of the first quarter. Adjusted EPS is planned to be at a loss of approximately $0.40 per share at the midpoint, incorporating an expectation for a higher tax expense versus the first quarter.

Free cash flow is expected to be positive in the second quarter primarily from inventory reduction. Our plan calls for earnings to inflect positively in the second half of the year, generating an annualized EBITDA run rate of approximately $1.3 billion to $1.7 billion. This range is similar to our view in February, and we believe this is the appropriate base to build off as we deliver our transformation savings over the next couple of years.

We are planning for the dynamic operating environment to continue and feel we have the strategy in place to successfully navigate our path forward as we remain focused on driving above-market long-term organic growth and margin expansion.

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

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

Thank you, Pat. We are continuing to forge our path forward. We made solid progress again in the first quarter with strong cost savings, inventory reduction and advancements across all elements of the transformation plan.

As we execute against our strategy in 2023 and over the 3-year time horizon, we believe our transformation efforts will begin to drive more material financial benefits. Our focus will be to continue to reinvest $300 million to $500 million of these benefits towards faster growth, as we strengthen the innovation machine and stimulate demand with enhanced end user activation.

We believe our actions to reshape, focus and streamline our organization, as well as reinvest in our core businesses, will enable us to deliver strong shareholder value over the long term via robust organic growth and enhanced profitability.

We have the best people, the best brands and the most powerful innovation engine in our industry. Combine this with the passion, energy and commitment I see across the organization every day, and it gives me great confidence that we will focus on what we can control to be successful, and we ultimately will recreate a significant market share gaining machine.

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

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Nigel Coe with Wolfe Research.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

And Pat, look forward to meeting you soon. And Don, congratulations on hiring Chris Nelson, someone we know really well. So good guy.

So my question is really just -- maybe just more detail on the Tools & Storage sales in North America. You talked about footprint of sales being above 2019 levels, but just wondering how that looked year-over-year, maybe the fact the Pro and DIY.

And then the pricing of 2%. To what extent was that a lot of promotional activity around maybe outdoor? And how do you see pricing trending through the year?

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

Yes. I'll give a little color on POS and then ask Pat to give a little color on the pricing part of the question. So I -- the POS trends are, obviously, when you look at them year-over-year, for some of our customers, they're down in the mid-single digits to high single digits.

Other customers are only down in the low single digits to flat.

So you got a mixed bag of different things happening there. But overall, we are seeing POS down year-over-year in Q1, and that trend will likely continue in Q2, at a lesser magnitude, because as the comp gets easier from Q1 to Q2, that trend will continue.

The trend around Pro continues to be very healthy. We're not seeing any major shifts in that dynamic. The consumer side continues to be relatively flat sequentially to what we've been experiencing for the last 2 or 3 quarters since the second quarter of last year. No major shifts there, but certainly not any strengthening on the consumer side as people continue to shift their dollars to different areas across the United States.

But overall, I would say POS is kind of trending the way we would expect. Outdoor is a little choppy in the last 6 to 8 weeks, as we saw a pretty rough March due to the weather. Things got better first half to the later stages of April, as the weather got better. And then obviously, we've seen a little bit of bumpiness in the last week or so as the weather hasn't been great in the Midwest and New England and Northeast in that time frame. And not to be a weather forecaster, but the weather is looking much better as we go into next week. So hopefully, that trend shifts back to a positive.

But it's a little bit of choppiness. I think all of us, the retailers, our customers, ourselves are all looking at probably the next month or so as to what the trends will be in POS, and that will really ultimately define the success of the season.

But I do think we've factored our guidance in a way that allows us to navigate that effectively. And Pat, maybe a little color on price.

Patrick D. Hallinan - *Stanley Black & Decker, Inc. - Executive VP & CFO*

The pricing environment has been stable. The price increase dynamic for us that you referenced in the first quarter was largely a carry-in price increase. Broadly in the channels and across competitors, the pricing environment remains stable. It appears to us that most in the market are focused on margin enhancement and, therefore, preserving pricing.

We don't expect additional price in our outlook through the balance of the year, so stable pricing. We will be given the supply chain improvements we've been making. We will be engaging in traditional seasonal promotions throughout the year, so that dynamic will be returning. But that's less of a new pricing dynamic and more of a return to traditional seasonal promotions.

Operator

Our next question comes from the line of Julian Mitchell with Barclays.

Julian C.H. Mitchell - *Barclays Bank PLC, Research Division - Research Analyst*

Maybe just my question would be around when you think about the uplift of margins from sort of low single digits to mid- to high single digits in the second half, maybe try to parse out how much of that is sort of sales uplift versus less destock versus less under production, and how we think about the phasing of third quarter versus fourth quarter earnings. Anything major to call out there?

Patrick D. Hallinan - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes. Most of that margin uplift from the first half to the second half is driven by gross profit margin uplift as opposed to some particularly strong volume or SG&A component. And most of it is as we get into the back half of the year, you'll have more of the progress in the transformation flowing through the income statement and less of the inventory destock and production curtailment, providing headwinds in that.

And the order of magnitude is in the 300 to 500 basis points of gross margin improvement first half to back half.

Operator

Our next question comes from the line of Tim Wojs with Baird.

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

And welcome, Pat. Maybe just on the channel, I guess, what do you -- it sounds like you've got kind of varying levels of kind of POS activity between your customers.

I mean, how does that kind of translate into channel inventory and kind of what they're holding and kind of what their comfort of current channel inventories looking like?

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

Yes. Thanks for asking that question, Tim, because I didn't really get into that when I was talking about POS. But yes, I would say the inventory levels in the channels and our major customers in North America and Europe are still high when you kind of look at traditional historical levels of inventory, but they are starting to come down.

And so we're starting to see improvement in that. And I think for us, in particular, the good news has always been that we weren't starting with a high level of inventory compared to maybe other folks within the industry and other competitors.

So when you look at Home Depot, as an example, we're not far away from where you traditionally see within a week or so of what we would typically want it to be and what they would want it to be. Lowe's is a little bit higher than that, but Lowe's tends to run at a much higher level of inventory, as we all know, versus Home Depot.

So we feel pretty good about it. I think you'll see a continued little bit of working down of our inventory in our customers in Q2 and maybe a little bit of that into Q3, as we work through the year, depending on where demand goes. So I don't think we're done with the destocking, but I think it's something that's very manageable for us versus maybe what some of our competitors are dealing with right now.

Operator

Our next question comes from the line of Josh Pokrzywinski with Morgan Stanley.

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

Don, I just want to maybe follow up on the SKU reduction. So for what you guys have contemplated and maybe what you've done so far, what has been the drag on organic growth? I guess, how much of that drops through to just kind of shelf space loss, et cetera, versus something you can backfill with similar products? .

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

Yes, that's a good question for me to clarify. Thank you for asking that. So we're being very thoughtful on how we do this. And so those 60,000 SKUs is a lot of SKUs. So when you hear about that, you start to wonder if that's going to have an impact on revenue.

But the ones that we've eliminated in the first phase really had very little revenue tied to them and very little inventory in the system. So it was really just eliminating something that hasn't really been selling over the last several years.

What you're left with now are the ones that -- which is about 45,000 SKUs that we stopped manufacturing. There's revenue tied to that, and there's inventory in our system tied to it as well. And so you need to go through a thoughtful process with all of our customers of conversion from those products to other products that exist in Stanley Black & Decker that are very similar in nature, whether that's a an upgraded version that has been upgraded through innovation and the customer is still selling the older version, it could be an example of that.

It could be an example of a brand being filled under a certain product and that we want to switch that brand over in that particular customer to a similar product, but a different brand, and that takes probably 12 to 18 months to navigate through.

And so it's going to be a very slow methodical process, with the overall objective being to not have an impact on revenue and to really minimize any potential write-offs that might exist in the world of inventory. And so far, the team has been very successful in doing that, but there's still a lot of work ahead of us.

And we have dedicated resources that are focused on this within our Tools & Outdoor business. And they have a very good grasp of the commercial aspects of this as well as supply chain. And I think they're doing an effective job so far navigating through it.

Operator

Our next question comes from the line of Michael Rehaut with JPMorgan.

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

And Pat, welcome, and nice to see you again, so to speak.

Patrick D. Hallinan - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Thank you.

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

First, well, I guess, my only question, I wanted to get a sense of -- maybe if I can kind of break it into 2 parts actually. One is just a clarification on the first quarter results. What drove the upside on the operating margins? I believe you're looking for something more flattish to 4Q.

But then secondly, on the guidance, you talked about Pro remaining healthy. I was just curious in terms of how you're thinking about Pro particularly in the back half. And when you think about Tools & Storage with the guidance and the base case, if that is looking for a positive inflection or just being more flat and how Pro figures in that.

Patrick D. Hallinan - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes, Mike, thanks for the question. In terms of the first quarter favorability, we are executing well on the transformation. And so the transformation is running ahead of plan, and we're feeling good not just about '23, but about the road beyond '23 and delivering on that transformation.

So I would say just when you get to the phasing of it throughout the year, that's more just -- it's difficult to predict perfectly how inventory rolls off your balance sheet and what level of inventory rolls off your balance sheet.

So I would say having guidance that's highly consistent with the original guidance of low 20% gross profit margins in the first half and high 20% gross profit margins in the back half is the way you should think of the business. You should have confidence in the transformation delivering that. And the way it flows quarter-to-quarter is always going to depend a little bit on mix and what type of inventory is coming off the balance sheet.

So I wouldn't subscribe anything other than that the first half gross profit margin, solid transformation performance and just an update on where the inventory is falling off the balance sheet.

In terms of the outlook of the end market dynamics in Tools & Outdoor for the balance of the year, we would expect what we've seen in the first quarter to persist throughout the balance of the year, which is continued strength in the Pro environment and a softer consumer environment, and that dynamic to be relatively consistent across the quarters.

But as Don mentioned in earlier Q&A, the comp gets easier as we get from the second quarter to the third quarter. So it's less about a change in end market buyer behavior in the last 3 quarters of the year, and it's more of the comp easing in the latter part of the year.

Operator

Our next question comes from the line of Chris Snyder with UBS.

Christopher M. Snyder - *UBS Investment Bank, Research Division - Analyst*

So the Q1 inventory reduction certainly seems to be tracking ahead of expectations, but you guys left the 1 HD stock guide unchanged at $500 million. Does this signal that maybe some of the destock was pulled forward into Q1 or should we think about potential upside on the rate of the first half destock? Because it does sound like Outdoor is improving in April relative to March.

Patrick D. Hallinan - *Stanley Black & Decker, Inc. - Executive VP & CFO*

Yes. I'd start by reiterating that we're committed to destocking $750 million to $1 billion for the year, and that's the commitment, and the team is working through that given a dynamic macro environment.

The reason to not change the flow throughout the first half and the second half is really channels remain conservative, as you would expect with a dynamic macro environment and relatively high short-term borrowing costs.

And so we'll continue to navigate the same environment that they're facing and achieve the year. But right now, it's just too soon to change our outlook on the first half and the second year -- second half inventory changes.

Operator

Our next question comes from the line of Eric Bosshard with Cleveland Research.

Eric Bosshard - *Cleveland Research Company LLC - Co-Founder, CEO, Co-Director of Research & Senior Research Analyst*

Patrick, I heard the guidance on the $750 million to $1 billion. I'm curious, as you think about solving that in an environment where retail inventories are a little bit heavy the demand is where it is. I'm curious as you think about promotions and really working through your inventory into an environment where things are slow and the inventories are a bit heavy.

Is there a desire to be patient in the pace at which you work through that inventory? Or is there an opportunity to be more aggressive through promotions to clear out that inventory through '23 to be better positioned for '24. How do you navigate or solve through that dynamic?

Patrick D. Hallinan - *Stanley Black & Decker, Inc. - Executive VP & CFO*

No, thanks for the question, Eric. Our inclination is to be more thoughtful around sales and operations planning. It is not our intent -- except for around the SKU rationalization areas, it's not our intent to drive an inventory change through aggressive pricing. That is not our intent.

We're going to be disciplined on pricing, and we're going to be focused on improving margins throughout '23 and beyond '23. So we'll be addressing that, Eric, really by internal planning around production relative to sales. And we'll update the guidance as appropriate as the macro unfolds and as channel behavior unfolds.

Operator

This concludes the question-and-answer session. I would now like to hand the call back over to Dennis Lange for closing remarks.

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

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

Operator

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