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EDITED TRANSCRIPT

SWK.N - Stanley Black & Decker Inc at Deutsche Bank Industrials Conference

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PRESENTATION

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

So we're going to go ahead and continue the day with Stanley Black & Decker. We have Don Allan joining us. Don is President and CEO, and he's been in that role since July 1, 2022. Prior to becoming CEO, he was President and CFO, and he joined Stanley in 1999. We also have Dennis and Cort from Investor Relations on the screen. And for those that don't know me, I'm Nicole DeBlase, and I'm Deutsche Bank's multi-industry electrical equipment and machinery analyst.

So Don is going to give a few comments to open the session, and then we're going to do this in a fireside chat format. For those in the room, if you have questions, just wave at me. If you're listening via webcast, feel free to send me an e-mail if you'd like to ask -- if you'd like me to ask any questions on your behalf.

So with that, Don, over to you.

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

Thank you, Nicole, and good morning, everybody. Appreciate the time (inaudible) with us today. And so I have 3 slides that I'd like to walk through, probably take about 10 minutes, and then we'll open it up to Q&A.

The first slide is just a little bit of a refresher of how we've become very focused on being a more streamlined company with great franchises. And clearly, the largest franchise would be our Tools & Outdoor business. You can see that about half of that business is made up of power tools and then the remainder is a quarter of outdoor power equipment, and hand tools and storage and accessories is the other 25% roughly.

Industrial still is an important part of our company and a large component of Industrial is engineered fastening as you can see, about 75% of that total portfolio, which serves the auto industry, aerospace industry and then general manufacturing infrastructure, which is primarily attachment tools. And we sold our oil and gas business a few months ago that closed. And so that's a business that actually does have some correlation to the independent dealer network for our outdoor business. So we try to really leverage the revenue opportunities across those 2 platforms.

The company now -- last year, revenue was about $15.3 billion, as you can see on the page in the market cap associated with it, strong dividend yield given where the stock price is right now, which we expect will change over the next year to 1.5 years as we continue to focus on being a very streamlined company and prioritizing what is important for this company's success going forward, which is going to be a focus on the iconic brands that we have.

As you can see in Tools & Outdoor, brands like DEWALT, STANLEY, CRAFTSMAN and BLACK+DECKER is kind of the top-tier primary brands. And then secondary brands, such as IRWIN, LENOX, Facom, PROTO, Mac Tools. And then on the outdoor side, we use DEWALT as our premier brand and then CUB CADET and HUSTLER as also our professional brand -- set of brands as well. Powerful innovation machine that existed for a long time in this company, and we're going to continue to invest in that and make it stronger going forward as a great electrification story that I'll touch on in a few minutes in that regard.

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We are a company, in Tools & Outdoor, in particular, that has the broadest category and channel coverage. And so when you look at our products, the channels we're in, the geographic locations, we are the broadest of all the different competitors in this space, and we are the #1 tools and outdoor company.

And last, but certainly not least, we have to leverage our operating model to make sure that we're successful going forward, and we meet the needs of our end users and our customers and the channels that those customers serve to the ultimate end users. We're a company that's been powered by people and guided by purpose for quite some time, and the purpose has been for those who make the world.

So if you move to the next page, most of you are aware that we've embarked on a pretty significant transformation as a company. It became very apparent that our supply chain like many companies has become very overly complicated and too long. And so we launched a significant supply transformation plan that I'll walk through on the right side of the page.

But before we did that, we focused on really this prioritization aspect and streamlining of Stanley Black & Decker as to where we're going to spend our money and the money that's invested in SG&A. And so we went to a process in June and July of really simplifying our priorities as we were investing in a lot of different things, some things that had short-term impacts in a very positive way, and then some things that would likely have a very positive impact in the long term, and we reprioritized those dollars and basically are saving $200 million as a result of those decisions across the corporate headquarters area primarily.

The second initiative was just making our organization simpler, less complicated and not as bureaucratic, removing spans -- I'm sorry, removing layers and increasing spans, and that has resulted in $100 million in annualized savings. And then the last is becoming a little more thoughtful around how we spend, what we call indirect dollars, which is basically be nonpeople dollars, and ensuring that we have sustainable change in this area. So as we make changes and we generate savings, it sticks in the P&L over the midterm and the long term. That will generate about $200 million of annual savings.

The first 2 items have been completed. The third item, we completed the first phase in 2022 and hit the objective for savings in this year. And then we'll get the remainder of the savings in 2023 of that $200 million. That, in total, is $500 million in annualized savings that is necessary for us to become leaner and more efficient in the areas that I mentioned, but it's also necessary for us to begin to invest in certain other parts of the company that are much closer to the end user and our customers, which I'll touch on in the next page.

The second category -- just go back, sorry, Christine. The second category is the activating the Phase 1 of our supply chain transformation. So we talked about this quite a bit since the earnings call in July. And we made a lot of progress to getting this up and running and moving in a more significant way in a rapid pace across the company. And we will have this fully launched and implemented in January of 2023.

We've started many things already. We're still in the planning phases of other areas such as facility consolidation as an example. But in the case of steward action and product platforming, strategic sourcing, we've already embarked on the beginning stages of that process, and, in some cases, are starting to generate some positive benefit in our P&L in 2022.

Operations excellence will be focused on more lean and efficient activities within our plants and DCs to ensure that we have sustainable productivity on an ongoing basis. The total savings expected from this program is $1.5 billion over a 3-year time horizon. And we believe this will be the lever, the primary lever that gets our gross margins back to 35-plus percent in that time for us.

This clearly has momentum at this point, but it is early days. And so we're excited about where we are. We have a long journey ahead of us, but we believe these savings are real. They've gotten to the stage now where, through the planning process, we have very detailed plans that are either have started or will be starting in the time frame that I mentioned, and we have resources that will be dedicated to this. And so as each week goes by and each month goes by, our confidence level on achieving the $1.5 billion gets higher and higher. And I would say, at this stage, we have about a 95% confidence that we can hit that objective over the 3 years.

So as I said, these are all great things to do to really make our company more efficient, improve the profitability, but we have to grow over the long term, too. And so on the next page, you'll see a little more color on that. The transformation is really about reducing complexity. As I had mentioned,

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$2 billion of savings over a 3-year time horizon, optimizing our corporate structure, focusing our operating model and really transforming our supply chain, as I just touched on.

And we're going to take a large chunk of that savings, about $300 million to $500 million over the 3 years, that's cumulative, and we will focus in certain areas of innovation. We need to go harder in electrification as in many of those categories are moving quickly from small gas engines to battery-operated solutions. And we want to make sure we lead that innovation curve as it happens and plays out, continue to be a market leader and making sure that we have a responsive supply chain and invest in that particular area.

So what does that mean, market leader? I think one of the things that we need to invest more in is user activation resources at the front end of the business, and those would be people out there interacting with our end users as to the new products that are going into the market, how are our products compared to our competitors, what advantage and differentiation aspects we have in those products, those are all things that we need to invest more in. Those resources exist today, but we need more of those feet on the street, so to speak.

The ultimate outcome is, we believe, this will enhance shareholder value over the long-term, and allow us to have a consistent organic track record of 2 to 3x the market, which we assess market as GDP. 35% gross margin, as I mentioned, by 2025. Strong annual free cash flow conversion of 100-plus percent and then the continuation and enhancement of a powerful innovation machine. And last, but certainly not least, a continued improvement in making sure that we hit our customer fill rate objectives and, ultimately, over time, are in the high 90s for fill rates on a consistent basis.

It's a clear vision and a very new strategy for long-term success. It's about prioritization, it's about focus and really making sure we stay true to the purpose-driven aspects of our company, and we believe that will deliver value to our stakeholders over time.

So that's my opening comments. I'm going to pass it to you, Nicole.

QUESTIONS AND ANSWERS

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Thanks, Don. I just want to start with some of the current trends, and then we'll go from there. So maybe can we just talk through what you're seeing from a retail point-of-sale perspective, both in the U.S. and Europe, and maybe any notable shifts or changes in the week following earnings?

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

Yes. I think the POS in the United States is generally being consistent with what we expected and the color we provided in October earnings call. So nothing really has changed there dramatically at this point. In the European situation, as you saw in the third quarter, our volumes in Europe were down almost 20%. So we're clearly seeing a significant -- it was -- about half of that was offset by price increases, but the volume number continues to be fairly significant decline in Q3, and we would expect a lot of those trends to continue in Q4, and that was part of our guidance that we provided back in October. So at this stage, we're not seeing anything that's really deviating from that.

Overall, I would say the month of October was in line with expectations because obviously, we're here in mid-November. Positive story around the P&L performance aligned with our forecast. And the inventory actually continued to decline in the month of October. So we saw roughly another $150 million of inventory decline in October, which is another positive step back that we saw a $300 million decline in inventory in the third quarter.

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Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Very clear. And I think as of the third quarter, you hadn't observed any signs of slowing on the professional side of the business, professional tools. Could that be the next shoe to drop? Is that the risk? And if that is the case, do you think the production curtailment plan may have to last a bit longer?

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

Yes. That's a good question. I mean it is the next question mark in everyone's mind because we have not seen slowing of the pro activity related to our products. And even as we sit here now, we're continuing not to see that slowdown. So that is the question I think most of us have for 2023 is, will there be a housing slump, will that obviously impact the pro construction worker, and therefore, impact our business.

So the manufacturing production slowdowns we've done have looked at a couple of different scenarios. We've looked at a scenario where that slowdown doesn't really happen that we kind of maintain current levels. We've looked at a scenario where we do have a slowdown and maybe revenue overall, on a volume basis next year, is down about 5%. And then we've also looked at a scenario that's a little more severe than that. And we factored that into our decision-making around production levels we're producing out right now.

The question that is in all of our minds and it's a question you just asked is, how long do you have to maintain these lower production levels? And so at this stage, we feel like it's something we probably need to maintain into the second quarter. And now if things are worse than of negative 5%, then we may have to go longer than that. It may have to go into some portion of the back half. That's kind of the unknown question mark at this point in time. But our primary focus us...

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay.

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

Our primary focus is, yes, trying to gauge where things might go next year, but we also have to make sure that we continue to liquidate inventory because if we liquidate inventory in a significant way next year, that will allow us to generate cash flow as long as the volume decline is not too severe.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Totally makes sense to me. And then on the supply chain, it seems to me like that's no longer a major constraint for Stanley, probably a combination of the actions you guys have taken internally to offset supply chain issues and what you're doing from an inventory perspective. Is that a fair characterization?

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

Yes, it is. I would say that the biggest constraint we have dealt with in the last 1.5 years has been semiconductors. And we started really bending the curve on that in the second quarter, but we didn't really get to the point where we were getting enough supply to meet the demand until the third quarter. And so as we exited the third quarter and went into the fourth quarter, we don't see that as a limiting item or constraining us at this point.

And we believe that with the inventory we have and the production we are maintaining in certain areas of the company, like an example is DEWALT power tools, we haven't really pulled back the production at all in DEWALT power tools because the demand has continued to be relatively strong

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in that category, which is representative of the pro construction worker. And so we -- based on the supply now for semiconductors, we can meet that demand, which is a big positive for us.

So at this stage, we don't think we're dealing with any supply constraints. It probably is a combination of what you said, which is the supply has gotten better, but also the demand has softened on -- in particular on the consumer side.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Got it. And just to kind of put a finer point on what you just said. So you mentioned that you're not slowing production in areas like DEWALT power tools that impact the pro. So is it fair then that the inventory reduction plan is really focused on what touches DIY consumer and maybe outdoor?

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

Yes, that's primarily -- I would say that there's certainly a big outdoor piece. There is definitely a consumer-oriented certain power tools and products. And then there's also, I would say, a hand tool, which is kind of a more pro and tradesmen, where there's higher levels of certain hand tool products that we would like that we have to kind of bleed off as well. And then I would say there's selective categories of DEWALT where we've had higher levels of production that wasn't necessarily tied to some of the semiconductor constraints. One example is, we have a fair amount of miter saw, as an example, in DEWALT product that probably is like a year's worth of inventory we need to bleed off.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. And I know Home Depot reported today. I have been doing fireside chats all morning, so I haven't had time to dig into what they've said about inventory. But, Don, when you guys talk about inventory curtailment, is this all factory inventory? Or are there signs that in the channel at the big boxes, et cetera, inventory levels are too high there, too?

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

I think the good news for us, Nicole, is we don't really necessarily have high inventories in our customers. I think the one exception might be to that, maybe 2. The European levels of inventory in our customers was -- earlier this year has been higher than we wanted, and that's been slowly kind of bleeding off, and we just clearly seeing the impact of volume of that as well as the underlying market conditions in Europe are very challenging because of the Ukraine war.

And then, in the U.S., the second item is just the bleed off of some of the outdoor product from the season that we just went through where the -- because of weather, it was just a very challenging season. And so that's bleeding to our customers as well. But the majority of the inventory that we're really trying to liquidate is items that is in our DCs. And so, the good news, I guess, from our point of view is, we don't have channels -- customer channels and other channels that are really full with inventory. I think, for the most part, when you look at Home Depot's weeks of stock, Lowe's weeks of stock for our product, they're actually at historical reasonable levels.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. That's good news. I just want to move on to the topic of market share. So I think you guys have recently talked about some evidence of some market share loss in power tools. I guess what's the plan to regain share in that business?

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

Yes, I think it's focused on a few different areas. So the first step was actually getting rid of the supply constrained. And so with the -- the reality is, with not being able to bring certain level of DEWALT product to the market. In some cases, certain CRAFTSMAN products, but primarily DEWALT because of the semiconductor challenge. We lost some share as a result of that over the last year, 1.5 years. And so now we're back in a place where we're able to meet the demand, and we met the demand for the holiday season that we're going through right now.

So if you go back and look at the last year to 1.5 years, we really have been -- not been able to meet the promotional calendar of our customers that happens in around Thanksgiving and Christmas and around Father's Day in the spring season. So the last 2 seasons, we've kind of missed out on that opportunity, which is a big reason of why we saw the share shift occur in the last year.

That's behind us. So we met the expectations of our customers for this particular holiday season. We shipped all their products in September and October and got high marks from our customers and making sure that we hit all those goals and objectives. So we're very pleased with that, and we're planning -- already planning the Father's Day spring season, which basically goes from Memorial Day through the end of June with our customers now to make sure we hit those promotional. They really were less promotional, really off-shelf opportunities.

So they're end caps, and they are in these other areas that are not in the tool crib that are kind of off-the-shelf area where they do a lot of their unique promotional activities are designed around the pro. And so we're lined up to really be back to where we used to be in those different parts of our customer store, which is part of what drove this share -- share loss over a period of time, a large part of it is driven by that. But I don't want to just say that's the only reason. I think we need to we need to be kind of reflective on some things that we can do better going forward.

And I would say there's 2 areas that we could be better. One, a little more investment in R&D. I mean, I think, we've done a great job with breakthrough innovation. We've had things like FLEXVOLT, POWERSTACK, DEWALT ATOMIC, DEWALT XTREME. These are all things that have been first-time unique products to the market that were very differentiated and have driven a lot of revenue for us. But on the core innovation side, we need that to be more consistent, more repetitive and really driving nuances and changes to functionality in a more consistent regular basis to drive new opportunities within our customers shelving areas or end caps, wherever the area may be. So we're going to invest more there.

We're clearly going to invest more in innovation on the electrification side because we see what's happening in outdoor and it's moving fast, and I think we're well positioned for that, but we got to put more investment in there to make sure we're moving at the right pace.

And then the last area is what I was mentioning briefly earlier, which is just these end-user resources that are out there interacting with the end users and really helping them understand why DEWALT has a better set of products than any of our competitors. And why when you look at our DEWALT premium products, the functionality clearly differentiates itself versus our competitors and making sure that our end users continue to understand that and recognize that, or if they have not been a DEWALT user in the past, you convert them over to being a DEWALT user going forward. That's an area that I think we have invested resources in, but we have not invested as much as I think we should, and that's going to be something we change going forward.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Very clear. And just on the topic of electrification, it seems like a lot of the investment is focused on the outdoor space. Do you think that's the big area of the portfolio where you do need to do work on electrification, and you're kind of set with that in the rest of the core tools business?

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

I think so. I mean, I think the core tools business will be a continued ongoing innovation around battery technologies like POWER STACK is a great example of a pouch technology versus cylinder technology for battery cells. We're going to continue to see innovation in that space going forward. But that's more of a refinement of a nuance of electrification versus a flip into electrification. And so I think that's more of where the journey that's going to be for power tools.

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It is clearly outdoor the vast majority of the investment. We will be making a little bit of investment in our Engineered Fastening business related to the flip in the automotive industry from the gas-driven engines to electrified vehicles and making sure that the business is well positioned for that. But they've been working on that for many, many years. So they are pretty well positioned today. It's just ensuring that we continue to put a little bit of additional investment in that each year.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Got it. Maybe moving on to the cost-cutting plan. I think you did a good job in the opening remarks kind of laying out where you are in the process of executing on that. I guess what -- the one thing that I was kind of missing in the model is, how are those savings spread from 2022 to the end state in 2025?

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

Dennis or Corbin, you want to take that?

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

Yes, sure. So I think the way to think about it, Nicole, first of all, in SG&A, we're going to have about $0.5 billion annualized by the end of next year. You can add to that approximately $500 million that will be in gross margin. So cost of sales reductions that can be supported as well by the end of '23. And then really the balance of it. So the additional $1 billion or so will be realized as we get into 2025.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Clear. Thanks, Dennis. And just on the Tools & Outdoor margins, this is where a lot of the inventory reduction plan is taking its toll. Understanding that 4Q is kind of like close to breakeven, what's the progression from there? Is 4Q as bad as it gets, and then you kind of expect margins to improve steadily throughout 2023?

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

I think Q1 margin rates will be similar to Q4. So you'll see another quarter of those types of gross margin rates, which obviously translates to similar operating margin rates. Q2 will start to get better. And then Q3 and Q4, you'll see sequential improvement. And I think we feel like, depending on what happens with volume, if we don't see a dramatic drop in volume next year, we feel like we could be approaching 30% by the end of the year for gross margins in the tools business -- Tools & Outdoor business. But that assumes a relatively stable top line. If we see it retract, then we'll be dealing with the question you asked earlier, which is we're continuing to reduce manufacturing for a longer period of time, which means that, that would delay the uptick of that a little bit.

Now what we haven't factored in into those gross margin estimates at this stage is how much deflation we can capture based on what's happening with commodities today. And so we're aggressively going after that at this point. It's something we're working through, through the remainder of this year to try to get a sense of the magnitude of that number for 2023. I mean a chunk of it is going to get hung up in inventory for a period of time.

So there'll be delays, and it's a question of how much you actually get in '23 versus '24. But that's something we're working through, that hasn't been factored into any of those numbers I just described.

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Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Got it. And, Don, what do you think about price stickiness, I guess, as we look into '23, especially as volumes are down? Is there a risk that, especially as you seek to regain share in power tools that pricing could become maybe, there, I say, a headwind, but I think more about like less of a tailwind than it has been in 2022?

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

Yes, I think the way that we're thinking about it is, clearly, there was -- we all know how these cycles work, where we have these big inflationary ways at the beginning. It takes a while to get price into the market. And so you miss almost 6-plus months where you don't get any price recovery. And you go through a period of time where you have pretty good price recovery, which is where we are right now, and then you see the deflationary trend play out, and then you're trying to hold down the price as long as you can.

I think when we think about that tail, we wanted to -- we believe it should be a positive arbitrage for us when you look at deflation and price. And it's really trying to manage that as effectively as we can over the next 12 to 18 months, recognizing that if you have a lot of deflation, you probably have to make a few price adjustments here and there. Also, you have to acknowledge that you've -- you missed out on a lot of the price recovery at the beginning of the cycle and how do you make sure you get a little bit of that benefit in the back end of the cycle. So we think we can still manage it as a positive net arbitrage, but it's early days to really conclude the magnitude of that right now.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Fair. Just maybe one question on Industrial. I don't want to leave the segment completely. In 2023, it feels to me like Industrial is kind of steady as she goes and most of this inventory reduction plan is focused on Tools. Is that fair? Like are you guys expecting 2023 to be an up year for Industrial, I would think so based on the end markets?

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

Yes. I think so unless something unusual plays out with automotive and aerospace. But I think, when I think about automotive, there's still a lot of people that can't get a new car. So there's still a significant supply constraints that are being dealt with in that space. Obviously, people have -- more and more people are traveling as each week and months go by. So I think that's going to continue to improve on the aerospace side.

So I think -- I do think we feel like there's growth next year. It's -- I think it's a question of magnitude. And -- but I think more importantly, there's an opportunity to continue to improve the profitability of the business. And so one of the things that we've talked to the team about is, okay, whatever the growth is, whether it's 5% or 10% or whatever the number is, or even if it's even lower than 5%, we should be able to do some pretty significant things with our supply chain transformation to ensure a fairly significant profitability improvement in the business. And that's really the focus. And so I think you'll have stability to growth on the top line. And then you'll see a more dramatic improvement in the profitability over '23.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Got it. I just want to shift to our last few topics, maybe the portfolio next. So you guys recently divested the Security business. You're now Tools & Outdoor and Industrial. Do you think this is the right structure for the company over the medium, long-term? And have you considered maybe splitting outdoor off into its own business segment?

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

I think there's a couple of questions in that. So I'll put the outdoor one as -- answer that as the second question. Yes, I think the question is, do we maintain Industrial going forward as part of the company? I think there's certainly overlap between our Infrastructure, Attachment Tool business

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and outdoor where, I think, there's some logic, but that to continue to be part of the company. Then you look at Engineered Fastening and say, what's the right decision there. At this stage, we see a lot of value in front of us that we can benefit from the recovery that's happening in automotive and aerospace and, in general, manufacturing.

And so I think our focus is to continue to improve the performance of that business. Even if we chose to make a decision to sell it right now, it's probably not the best market to sell a business, given financing markets and other areas. So there isn't a lot of logic to pursue anything other than continued improvement of the operational performance of the business. And I think that's the course we're going to stay on, and then we'll ultimately have a discussion with our Board. It's a topic that is ongoing with our Board, and we'll continue to have that conversation as the next 12 to 24 months play out.

On the outdoor side, I actually -- we actually have had this debate as to should outdoor be separate from the tools, and there's so many synergies of those 2 businesses to being together. Obviously, the customers, in many cases, in many channels, are very similar other than the independent dealer channel where the pro landscaper does a lot of their purchasing. That's probably a little bit unique. But then, again, it's an opportunity for our Tools business to get more of their product into that channel. So I think they can leverage that opportunity.

Clearly, the retailers are common to both those businesses. The innovation overlaps are significant around battery technology and really leveraging the electrification work we've done on power tools, to handheld outdoor and eventually to the bigger outdoor pieces of equipment. So there's synergies there. The brands are shared across many of the products. So it actually feels more like it belongs together versus separate. But I think, ultimately, what will happen over time, they probably won't be 2 separate segments, but we'll probably continue to provide color on both pieces or both SPUs related to it.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Makes sense. Free cash flow, so there's a lot of moving pieces right now. I guess when do you think free cash conversion, or whatever metric you want to use, will return to more normalized levels? Is there prospects for that to happen at some point in 2023?

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

Yes, I think so. I mean, I think, the first half of '23 is going to continue to be challenging from a P&L perspective. And then if things play out the way I describe, I think we'll start to see that improve fairly significantly in the back half of next year. I do think because we have the inventory that we really need to liquidate, and that number is anywhere from $1.5 billion to $2 billion. And I think, right now, we feel like we'll be in to make good progress again here in Q4 in inventory liquidation, probably a number similar to what we saw in Q3 or bigger.

Next year, we probably need to be somewhere between $700 million to $1 billion of inventory liquidation. And that will position us very well from a cash flow point of view in 2023. And so as we get into the back half of the year, I think you'll start to see conversion rates that are pretty strong.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Okay. Great. Last question for you before we run out of time. So I know you are focused on debt pay down right now. That's the #1 use of capital allocation. But I guess, once your balance sheet leverage does return to the long-term target, what are the key focus areas for deals for you?

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

Well, I think, there'll continue to be an interesting dynamic of some bolt-on transactions we can do that will help us in different geographies across the world. As many of you know, there're certain parts of the world where our business is not as strong as we would like to be. And we tend to want to be #1 or #2 in every market we play in. And so Germany and Japan are good examples of that. Emerging markets continues to be a great

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opportunity, and we've made nice progress over the years, but the market share is still pretty low in various emerging markets around the world, on average, it's about 4% or 5% market share.

And so I think that's an opportunity to look at probably more select bolt-on acquisitions. And then there's always the opportunity of a couple of strategic larger acquisitions that fill a need in our portfolio. There's a couple out there. There's not a lot, but there's a few out there that are potential things that we could do most likely be sometime in '24 before that would play out.

But right now, I think we feel really good about the internal organic core focus of what we need to do and not really distracting our team with thoughts of acquisitions. But myself and the Board and Corbin, who is our interim CFO, but was our M&A leader and will be our M&A leader once we fill that role with our permanent CFO. We continue to think through what are some of the alternatives as we move beyond the next 15 and 18 months.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Well, we'll go ahead and wrap it up there. Thank you so much for participating, Don, Dennis Corbin. Good to see you over Zoom, and hope you have a good rest of the day.

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

You too. Thanks.

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

Thanks, Nicole.

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

Good bye, Nicole.

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