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Leggett & Platt, Inc. (LEG)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Leggett & Platt Fourth Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Ms. Wendy Watson, Vice President of Investor Relations for Leggett & Platt. Thank you. You may begin.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

Good morning and thank you for taking part in Leggett & Platt's fourth quarter 2019 conference call. I'm Wendy Watson. With me today are Karl Glassman, Chairman and CEO; Mitch Dolloff, President and COO; Jeff Tate, Executive Vice President and Chief Financial Officer; and Susan McCoy, Senior Vice President of Investor Relations.

The agenda for our call this morning is as follows: Karl will start with a summary of the major statements we made in yesterday's press release. Jeff will discuss financial details and address our outlook for 2020. And, finally, the Group will answer any questions that you have.

This conference call is being recorded for Leggett & Platt and is copyrighted material. This call may not be transcribed, recorded, or broadcast without our express permission. A replay is available from the IR portion of Leggett's website.

We posted to the Investor Relations portion of the website yesterday's press release and a set of PowerPoint slides that contain summary financial information along with segment details. Those documents supplement the information we discuss on this call, including non-GAAP reconciliations. I need to remind you that remarks today concerning future expectation, events, objectives, strategies, trends, or results constitute forward-looking statements. Actual results or events may differ materially due to a number of risks and uncertainties, and the company undertakes no obligation to update or revise these statements. For a summary of these risk factors and additional information, please refer to yesterday's press release and the section in our 10-K and 10-Q entitled Forward-Looking Statements and Risk Factors.

I'll now turn the call over to Karl.

Karl G. Glassman

Chairman & Chief Executive Officer, Leggett & Platt, Inc.

Good morning and thank you for participating in our fourth quarter call. First, I want to thank our dedicated fellow employees around the world for your efforts during this past year. In 2019, our employees accomplished the acquisition and integration of ECS, the largest acquisition in our history; the very successful restructuring of our Home Furniture business, where we are already seeing an EBIT margin benefit; the orderly closure of our Fashion Bed business and successful liquidation of that inventory; all while keeping a sharp focus on deleveraging; generating record cash from operations and delivering our 48th consecutive annual dividend increase. This represents tremendous work by our employees across the company, and these efforts are very much appreciated. Thank you, all.

As a reminder, in November, we filed an 8-K that discussed changes to our segment structure. These changes align with how we manage our businesses. Effective January 1, 2020, all of our Bedding-related businesses, including our Innerspring and Specialty Foam businesses, our Steel rod and Wire and Machinery businesses, and our Adjustable Bed business will be one Bedding product segment. This optimizes efficiency and allows us to holistically manage our Bedding value chain of rod, wire, spring, specialty foam.

The newly formed Furniture, Flooring and Textile Products segment will contain our Home and Work Furniture businesses, our Flooring Products business, and our Fabric Converting and Geo Components businesses. Our Specialized Products segment is not changing and includes our Automotive, Aerospace, and Hydraulic Cylinder businesses.

The segment commentary in yesterday's press release is based on the historical reporting format, as we continued to report under the prior segment structure through 2019. Before we report first quarter 2020 earnings, we will furnish an 8-K providing five years of historical segment data based upon the new segment reporting structure.

We have several items to highlight in our 2019 performance. Full-year sales grew 11%, EBIT grew 18%, and adjusted EBIT grew 12%. Full-year EPS was $2.47 and adjusted EPS was $2.57, a 4% increase over 2018 adjusted EPS. We generated record operating cash flow of $668 million. Adjusted working capital as a percent of annualized sales improved to a low 9.9% at year-end.

We experienced fluctuations in sales and earnings from the effects of raw material cost, primarily steel scrap cost and selling prices for steel rod, wire, and innersprings, along with corresponding movements in LIFO benefit or expense.

We passed our steel cost increases or decreases along to our customers after an approximate 90-day lag. Because of this lag, in the first half of 2019, our selling prices for steel rod, wire, and innersprings increased from the recovery of cost inflation that occurred in 2018. At the same time, our costs for steel scrap were deflating. This had a positive impact on both sales and earnings, as sales dollars were increasing and earnings benefited from the lower cost. In the second half of 2019, we began to pass our lower steel scrap cost along to our rod, wire, and innerspring customers.

Despite the downward effect of our – on our sales dollars, we continue to experience earnings growth from steel cost deflation through October of 2019. We also experienced increased earnings from LIFO benefit as steel costs deflated.

Steel scrap costs began to rise in November 2019 and have continued inflating through January of 2020. We expect steel movements to cause sales and earnings fluctuations in 2020 and anticipate negative earnings impact in the first quarter. We also expect year-over-year changes in LIFO, as we had a $32 million LIFO benefit in 2019.

As the course progress, we will update you on the changes in steel scrap and rod and our full-year LIFO expectations. While we are most affected by moves in steel scrap and rod, we also experienced a negative effect on sales from foam chemical deflation in our ECS business that I will discuss later in the call.

Fourth quarter sales increased 9% to $1.14 billion. The ECS acquisition added 13% to sales in the quarter. Organic sales were down 4%, 1% from volume and 3% from raw material-related price decreases and a negative currency impact. Most of our businesses grew in the fourth quarter. The growth was more than offset by the planned exit of business in Fashion Bed and Home Furniture, which reduced sales 3%, and continued weak trade demand for steel rod and wire. Absent declines from exited businesses, volume was up 2%.

We are pleased with the performance of our Bedding businesses in the quarter. U.S. Spring sales were up 7%, International Spring sales were up 4%, and Adjustable Bed sales were up 22%. In addition, our Automotive business was up 8% in the quarter, while global auto production was down 5%. Our Aerospace business was up 11% in the quarter.

Fourth quarter EBIT increased $51 million over fourth quarter 2018, and adjusted EBIT increased $20 million, or 17%, to $140 million. Adjusted EBIT benefited from the ECS acquisition even after $12 million of amortization expense, lower raw material costs, including LIFO benefit, and improved earnings performance in Furniture Products. Adjusted EBIT margin increased 70 basis points to 12.2% and adjusted EBITDA margin increased 160 basis points to 16.4%.

Fourth quarter earnings per share were $0.64. This included restructuring-related charges that reduced earnings $0.04 per share. Adjusted fourth quarter earnings were $0.68 per share, a 10% increase versus fourth quarter of 2018. The increase in fourth quarter earnings reflects higher adjusted EBIT, partially offset by higher interest expense and tax rate.

For the full-year 2019, sales grew 11% to $4.75 billion, ECS and other smaller acquisitions added 14% to sales. Organic sales were down 3% on 3% lower volume. Raw material-related selling price inflation from increases implemented in late 2018 were offset by a negative currency impact.

Full-year organic sales growth in most of our businesses, including U.S. Spring, Automotive, Work Furniture, and Aerospace, was more than offset by the planned exit of business in Fashion Bed and Home Furniture, which reduced sales 3%, and weak trade demand in steel rod and wire. Volume was flat for the year absent declines from exited business.

Content gains continued to drive sales growth in both our Bedding and Automotive businesses in 2019. U.S. Spring sales were up 6%, benefiting from the continued shift to higher-value innersprings. Our Automotive sales were up 2% for the year, with global auto production down 6%.

Full-year EBIT increased $76 million and adjusted EBIT increased $56 million, or 12%, to $529 million. Adjusted EBIT benefited from the ECS acquisition even after $50 million of acquisition accounting, lower raw material cost, including LIFO benefits, and improved earnings performance in our Furniture Products segment. Full-year earnings per share increased to $2.47. Adjusted earnings per share increased 4% to $2.57. Adjusted EPS benefited from a higher EBIT, partially offset by higher interest expense and tax rate.

In January 2019, we acquired Elite Comfort Solutions and gained critical capabilities in proprietary foam technology, along with scale in the production of private-label finished mattresses. ECS' full-year 2019 sales were flat with 2018, primarily from deflation and weaker demand in non-bedding markets. Volume was up 11%. As expected, ECS' EBITDA margin is accretive to our total company EBITDA margin and their cash flow generation is strong.

In the fourth quarter of 2018, we initiated restructuring activities after an in-depth analysis of our Fashion Bed and Home Furniture businesses. Total restructuring-related charges were $15 million in 2019 and $16 million in 2018. The restructuring activity is substantially complete.

In November, the US mattress industry's antidumping petition on imported Chinese mattresses came to a successful conclusion with the International Trade Commission making a unanimous final determination that the US industry had been materially injured by Chinese mattresses sold at prices that violate the US trade laws. Jeff will discuss our 2019 financial details and full-year guidance for 2020.

I'll now turn the call over to him.

Jeffrey L. Tate

Chief Financial Officer & Executive Vice President, Leggett & Platt, Inc.

Thank you, Karl, and good morning, everyone. In 2019, we generated record cash flow from operations of $668 million, a $228 million increase over 2018. This improvement was driven by a significant reduction in working capital across the company and strong operating cash generation in many of our businesses, including ECS. We ended the year with adjusted working capital as a percentage of annualized sales of 9.9%, an improvement versus 10.6% at the end of 2018. In addition, we brought back $96 million of offshore cash in the fourth quarter, bringing our full-year total to $279 million.

In November, we declared a $0.40 per share quarterly dividend, a 5% increase versus the fourth quarter of 2018. At yesterday's closing price of $46.96, the current yield is 3.4%, which is one of the higher yields among the S&P 500 Dividend Aristocrats.

Consistent with our deleveraging plan, share repurchases were limited in 2019. For the full year, we repurchased only 700,000 shares of our stock, primarily surrendered for employee benefit plans at an average price of $44.20. We issued 2 million shares primarily for employee benefit plans and stock option exercises.

From an acquisition perspective during the year, we acquired ECS and one small Geo Component operation. We also continue to invest in capital to support organic growth opportunities. Total capital expenditures in 2019 were $143 million, 10% lower than the prior year, reflecting a balance of investing for the future while controlling our spending.

Our financial base remains strong. We ended 2019 with debt at 2.9 times our trailing 12 months' adjusted EBITDA. We remain committed to maintaining a strong investment-grade credit rating and continue to expect to de-lever to a ratio of debt-to-trailing 12 months' adjusted EBITDA of approximately 2.5 times by the end of 2020. We expect to accomplish this by limiting share repurchases, controlling the pace of acquisitions, and using our operating cash flow to repay debt.

We assess our overall performance by comparing our total shareholder return to that of peer companies on a rolling three-year basis. Our target is to achieve TSR in the top third of the S&P 500 over the long-term, which we believe will require an average TSR of 11% to 14% per year. Our annual TSR was below the 11% to 14% target in both 2017 as well as 2018, but significantly above the target in 2019. Over those same years, the TSR of the S&P 500 was well above historical averages. As a result, our recent three-year performance did not meet our top third goal. However, we believe our disciplined growth strategy, portfolio management, and prudent use of capital will support achievement of this goal over time.

Now moving to a discussion of our 2020 guidance. 2020 sales are expected to be in the range of $4.7 billion to $4.9 billion, or down 1% to up 3% over 2019. Acquisitions in 2019 should add 1% to sales growth in 2020. Raw material-related price decreases implemented in the second half of 2019 should have lowered sales 1%.

We expect mid-single-digit volume growth in 2020 for most of our major businesses. This includes Automotive, U.S. Spring, ECS, Aerospace, Geo Components, and Work Furniture. We also expect the growth in these businesses to be offset by approximately 1% of further year-over-year sales decreases from planned exit volume in both Fashion Bed and Home Furniture, as well as continued weak trading demand for steel rod and wire. So, as in exited business, volume is expected to be flat to up 4%.

2020 earnings per share are expected to be in the range of $2.40 to $2.60, reflecting earnings growth in our Automotive, Bedding, and other businesses to be more than offset by increasing steel costs, including the non-recurrence of 2019's LIFO benefit.

Additionally, we expect increased costs in 2020 because of investments we're making to support the growth, security and continuity of the company. These investments include network and cybersecurity upgrades and personnel to support those activities. We're also investing in our human resources organizations and related technology.

Finally, employee benefit costs are increasing due to a valuable change we made to our 401(k) plan, adding employee auto enrollment. We're very pleased that this change increased employee participation rates in the 401(k) plan.

Earnings per share guidance assume the full-year effective tax rate of 23% versus 22% in 2019. We expect 2020 depreciation and amortization to approximate $200 million, net interest expense of approximately $80 million, and fully diluted shares of 136 million. Based upon this guidance framework, our 2020 full-year adjusted EBIT margin should be in the range of 10.7% to 11%. Cash from operations should approximate $550 million in 2020. Capital expenditures should approximate $160 million for the year, and dividends should have required $220 million of cash.

Finally, we know impacts from the coronavirus, are top-of-mind for many of you, and we're closely monitoring global developments. Our current 2020 guidance does not include possible impacts from the virus. It's still too early to develop reasonable quantitative data related to the impact. Our first priority is the health and safety of our employees around the world. For our employees in China, we've extended the Lunar New Year plant shutdowns in accordance with Chinese provincial and local government extensions. We're establishing protocols in all 16 of our Chinese facilities to better protect our 5,200 employees in China when they can return to work.

And for all Leggett & Platt employees around the world, we've implemented a travel ban to Asia, and are severely restricting all international travels. We're assessing the potential impact of this pandemic on our business, including demand for our goods and our customers' goods, inventory availability through our supply chain as well as our customers' supply chain, the global movement of goods and workforce availability. We do not anticipate that there are factors unique to us that will cause the impact from this coronavirus to be greater to our company than our global manufacturers – than other global manufacturers. We continue to monitor the situation and will take all reasonable mitigation steps as facts unfold.

With those comments, I'll turn the call back over to Wendy.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

That concludes our prepared remarks. We thank you for your attention and we will be glad to answer your questions. To allow everyone an opportunity to participate, we request that you ask only one question and then yield to the next participant. If you have additional questions, you are welcome to re-enter the queue and we will answer those questions as well. Melissa, we're ready to begin the Q&A session.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Susan Maklari with Goldman Sachs. Please proceed with your question.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Good morning, everybody.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Good morning.

Jeffrey L. Tate
Chief Financial Officer & Executive Vice President, Leggett & Platt, Inc.

A

Good morning.

Susan McCoy
Vice President-Investor Relations, Leggett & Platt, Inc.

A

Good morning, Susan.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

I guess, my first question is just can you talk a little bit to ComfortCore maybe in the quarter, overall Bedding, how that did, and anything that we should be aware of in the channel as we head into the Presidents' Day weekend and kind of the sales events around that?

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.

A

Sure. This is Mitch, Susan. So, for ComfortCore, units continue to be very strong on the U.S. Spring side, They were running at about 62% of units for the quarter and about 48% of those included our Quantum Edge as well. So, I think that the Bedding outlook continues to be strong and I'll let Karl comment on any trends going forward into that – the holiday week.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Good morning, Susan. That, as Mitch said, the continued adoption of ComfortCore, driven somewhat by the growth of hybrid mattresses, both compressed and uncompressed. It is at a level – at a rate of 62% for the quarter and 56% for the year that we didn't anticipate. So, we're pleased with that – with the launch of new product lines at the Las Vegas market, which was last weekend, that there was a greater introduction of ComfortCore.

The bedding industry feels pretty optimistic in terms of that there's relative stability in that industry, which is kind of a change compared to the last five years, and advertising investments seemed to be in place, new product launches, so there's excitement around there. We feel pretty good. Presidents' Day is a tough one to call. I know there'll be heavy advertising going into it, but it's always one of those holidays that its performance is subject to weather, just because of being in February. But there's a buildup to it. We're excited, Bedding was a great story in 2019 and we expect the same in 2020.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Great. That's very helpful. And then, you gave a lot of color around the impacts that you've seen over the last year and then into the beginning of this year from steel prices and understanding that it's kind of hard for you to project going forward, but can you just kind of give us some sense of maybe what's going on in that market? You talked to the weakness of trade demand in your rod and wire segment in there. So, can you just talk a little bit to how we should think about that as we move through 2020, what's driving that weakness in demand and any other color there?

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Yeah. Let's talk first, pricing, and then we'll go through weakness in trade demand, which is very different than our internal demand. But what happened is a continual deflation of input costs as 2019 progressed until November, where we saw the first move up in scrap. So, we saw steel scrap inflate in November at a rate of $20 a ton, followed by $25 a ton in December, and then $30 a ton in January. So, we're dealing now with kind of the reverse lag effect from the standpoint that as prices deflated in 2019, we kept that benefit for 90 days. We're flipping that situation in 2020. But because of the kind of the oddities of year-end, we actually are – decreased our customer prices in January of 2020, because we adjust every quarter. So, we're – those contracts actually in the face of our increase in input costs, we lower prices because of lag effect. We will be increasing our customers' prices starting in April. So, with that, there is a LIFO swing. There is zero impact of LIFO expense in our forecast for 2020 as we laid out guidance. But who the heck knows to your point. So, that's what's happening from a pricing standpoint.

From a trade market perspective, again, this is trade, so think of us for about the 25% of the total tons that we produce from the perspective as you would a large public steel company. In that case, we're like them from the standpoint that our metal margins are okay. Margins aren't so bad because of the deflation cycle, but the demand is incredibly soft. It's not specific to any particular sector. It's just macro, US economic and export demand for steel products in virtually every channel of distribution. So, people may question, well, wait a second, the steel – US steel industry was protected by Trump tariffs last year. Well, the products weren't. So, there was a continued inflow of products in an environment where export demand was very, very soft. So, from a trade perspective, that's really what happened in 2019, and we don't see a change in that in 2020. So, I apologize for the long-winded answer, but steel moves are really, really complex.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. No, that's very helpful, and it sounds like it's having quite an impact on the 2020 and how we think about the guidance. So that's really helpful for us. And it seems like...

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

It's really just not quarter perspective, Susan. So, expect 1Q is going to be negatively impacted by that pricing decrease, while costs are rising. So, yes, it is impacting the – kind of the quarterly sequencing.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then as we go through the year, though, your comps also in that segment, I know the segments are going to change, so it's going to make it a little – that's going to change things as well for us. But the comps get a little easier and then as we move through the year from a revenue...

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Said differently, we'll become more fully recovered from a margin perspective. But to revenues, you are right, because we have the business that we appropriately walked away from that still impacts us in the first half of the year that we anniversary. So, Fashion Bed, that kind of headwind of Fashion Bed really goes away in the back half of the year, but we still deal with that legacy exposure in the first half, and Home Furniture has a little of that same situation. But we'll move to an inflationary environment which will help offset some of that from a top line perspective.

Susan R. McCoy
Senior Vice President-Investor Relations, Leggett & Platt, Inc.

A

Susan, I'm going to...

[indiscernible] (00:29:34)

Susan R. McCoy
Senior Vice President-Investor Relations, Leggett & Platt, Inc.

A

...go ahead and take an opportunity here really quick. You didn't specifically ask a question about kind of progression of sales guidance, and in margin, sort of progression through the year. But Karl has introduced that idea already, so I'll complete that discussion by saying, just to be clear, as we look at quarters throughout 2020, we expect sales in the first half of the year to be down slightly, and then in the second half of the year to be up slightly in some of the stuff that he was talking about, you guys have alluded to, there's more impact from the excess volume in the first half of the year. We've got the flip from deflation to inflation by the second half of the year. We expect to anniversary most of the excess volume. So, that's on the sales side.

On the earnings side, we would expect to see our quarterly margins. The margin trend to be very similar to what we experienced in 2019, including the first quarter being lower than our expectations for the rest of the year and that gets to this steel lag that Karl is talking about a flip on the steel side. And then for the full year, we would pattern the margin progression basically to be flat to down slightly versus each quarter in 2019 and then for the full year of 2019.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Okay. All right. That's very helpful. And then I assume like as we get closer to you restating the information according to the new segments too, we'll get some of that historical, so we'll have a sense of how to model it going forward?

Susan R. McCoy
Senior Vice President-Investor Relations, Leggett & Platt, Inc.
A

Absolutely.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Yeah.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

And it...

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Okay.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

...it actually will help things. Having the historic Industrial and Residential pulled together in this Bedding segment, I think it should help, because there's been this kind of offset, you had to read through to try to figure out where the impact and when the impact in Industrial was rolling through Residential. So, I think it will help you from an analytic standpoint and, more importantly, it's how we manage the business.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. No, I think it's going to be very helpful and especially as we get ECS in there and a lot of those pieces of that supply chain. So, I think it is going to be helpful, so, yes.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Thank you.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

All right. Well, I will let somebody else talk...

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

We're spending a lot of time on that. So...

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

...I know. I'm going to let someone else talk now.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Thanks, Susan.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

All right. Thank you.

Operator: Thank you. Our next question comes from the line of Daniel Moore with CJS Securities. Please proceed with your question.

Daniel Moore
Analyst, CJS Securities, Inc.

Q

Thanks. Good morning.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Good morning, Dan.

Jeffrey L. Tate
Chief Financial Officer & Executive Vice President, Leggett & Platt, Inc.

A

Good morning.

Daniel Moore
Analyst, CJS Securities, Inc.

Q

I guess, I wanted to start with, well, just one or two real quick. Number one, can you quantify dollar amount or EPS impact of increased costs for some of the investments you've described, network, cybersecurity, et cetera, as well as the increased employee benefit related costs in 2020 versus 2019?

Jeffrey L. Tate
Chief Financial Officer & Executive Vice President, Leggett & Platt, Inc.

A

This is Jeff. Good morning. That number is approximately $10 million in total.

Daniel Moore
Analyst, CJS Securities, Inc.

Q

Between the two?

Jeffrey L. Tate
Chief Financial Officer & Executive Vice President, Leggett & Platt, Inc.

A

Between the two, correct.

Daniel Moore
Analyst, CJS Securities, Inc.

Q

Perfect. And second is more philosophical but, obviously, you remain committed to deleveraging, which I know a lot of investors appreciate. Given the guidance, a little light relative to expectations, as well as just the incredible powerful cash generation, why be quite that rigid if the shares were to come under pressure for any reason, disappointment, whatever, why not be perhaps a little bit more opportunistic and flexible regarding potential buybacks?

Jeffrey L. Tate
Chief Financial Officer & Executive Vice President, Leggett & Platt, Inc.

A

Dan, this is Jeff again. Again, thank you for the question. I think that's a very appropriate one. But I think if you'll go back and look at what we discussed at Investor Day, I think we're going to stay very disciplined, very methodical and very intentional with our uses of cash. I mean, for us, we're going to continue to invest for growth from a prioritization standpoint, we're going to continue to protect the dividend, and we're going to continue on the path to reaching our deleveraging commitment that we've made to all of our stakeholders, and after that would come share repurchases as a potential opportunity as well as acquisitions that may come down the path as well. So, the point is well taken. But, for us, we're going to continue down that sequential path in terms of our prioritization of uses of cash.

Daniel Moore
Analyst, CJS Securities, Inc.

Q

Okay. Understood. I'll pass that over. Thank you.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

A

Thanks, Dan.

Operator: Thank you. Our next question comes from line of John Baugh with Stifel. Please proceed with your question.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you and good morning. I guess we'll start with ECS. Could you clarify, I wasn't clear, because I'm interested in volumes in Q4 and the year, I think you said that year was up 11%? And then, of course, you talked about non-bedding being weak, I'm curious for 2020 in terms of the guide. If we're looking at, I think, mid-single-digits of volume up for ECS, how does that sort of break out between non-bedding and Bedding?

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.

A

Okay. Hey, John. This is Mitch. Yeah. So, for – I think we've seen the same trend that we saw in 2019 in terms of decline in some of the non-bedding market, but continued strong opportunities in 2020 in the bedding markets, both with pure foam mattresses and hybrid mattresses.

[indiscernible] (00:35:39)

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

It is really – yeah.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

A

Sorry, sorry....

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Go ahead.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

A

We're going to see some continuing deflation in 2020. And it's – and some of it due to just that softness in the furniture markets and the furniture brands that ECS held.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. So, is the mid-single-digit guide for volumes for ECS for 2020 comprised of high-single or almost double in Bedding and declines in non-bedding, or any help?

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Yeah, John. I think that's accurate. And that melt-off of non-bedding can move to Bedding from a margin perspective is good for us. Remember, the non-bedding tends to be blocks of commodity foam to the most part replaced by higher-value bedding-related products that may be either specialty foam components or finished mattresses. So, the answer to your question is, yes. We would expect that the Bedding-related side of it would be in the double-digit range. The net 5% is a continuation to Wendy's point of deflation which continued through the year, even into the fourth quarter, and the softness of the non-bedding business.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Great. Thank you. And then, in the 2020 guide, again it looks like, I guess, excluding the exiting of the Fashion Bed and the home furnishings, but is the guide for volume exclusive of the exits also down and, if so, sort of how much and why?

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

At the midpoint, it's up about 2%.And there's an expectation – we rattle off all these businesses that are growing mid-single-digits, and you heard that list, [ph] so you – some of them is down and that's a continued expectation of soft demand in the trade steel industries is the primary driver of that.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay. Okay. And then, incredible job on working capital in the year and a huge source of cash, particularly in Q4 on accounts receivable. Jeff, was there something timing-related there or how do we think about either working capital as a percentage of revenue for 2020 or what are some of the big moving pieces on that? Obviously, it's a tough compare.

Jeffrey L. Tate
Chief Financial Officer & Executive Vice President, Leggett & Platt, Inc.
A

Right. Thanks for the question, John. First of all, the team, you're right, did a tremendous job on working capital during the course of 2019 and you saw that reflected in the 9.9% ratio there. I mean, there were quite a few yeoman efforts that were contributors in 2019, especially the combination of liquidating the inventory of the exited businesses that we've highlighted during the call, I mean, increased overall, and the focus of inventory-level reductions. You saw the deflation of raw material costs throughout the course of 2019 that also contributed to that.

As we think about 2020, John, for us, the rigor and the focus will not change or will not let up at all as it relates to our working capital efforts and improvements, but we don't see where we will have as many of those significant huge wins that we saw in 2019 and 2020. However, again, the focus will continue to be there, and we'll continue to drive that result as best we can across the organization.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Great. And my last question is just sort of this high level of focus that's taking hold on the investment side of the world on ESG. And I'm wondering kind of where you are internally thinking about that whether you've hired a consultant or are sort of measuring yourself what early inning gleanings you may have on that and what we might expect going forward? Thank you.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.
A

Yeah. Hi, John. This is Wendy. Yes, we are working on ESG. We hope to finalize our first sustainability report sometime in 2020. We are working with some external consultants to help us. As you know, we feel like we've long been doing the right thing and have a really strong story to tell from an ESG perspective. But gathering all that information from our different businesses around the world had been a challenge and so we have some help to do that. So, we're – thanks for the question and we're looking forward to being able to issue that for sustainability report. But there is a lot of work going on across the company on those factors every day, not in order to report great ESG but because it's the right thing to do in our businesses, but we are going to be pleased to be able to report them later this year.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Great. Thank you and good luck.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

Thank you, John.

Operator: Thank you. Our next question comes from the line of Bobby Griffin with Raymond James. Please proceed with your question.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.
Q

Good morning, everybody. Thank you for taking my questions and I...

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

Good morning, Bobby.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.
Q

...hope everybody is doing well. But just quickly, I want to go – Susan, I want to go back to your comments about the regression for the year just to make sure I'm grasping it correctly, but for 1Q based on the steel sequential kind of inflation that you're seeing from steel on the input side, we would want to model [ph] or (00:41:06) the expectations for 1Q EBIT margins to be down year-over-year in the low point of 2020.

Susan R. McCoy
Senior Vice President-Investor Relations, Leggett & Platt, Inc.
A

We would, year-over-year in the first quarter, expect the – each of the quarters, not just the first quarter but each of the quarters to be maybe in line with or slightly below what the prior year's quarter was. That means sequentially it goes down from fourth quarter to first quarter because of the steel issues that Karl was talking about, just normal seasonality, frankly, with our – from fourth quarter to first quarter in that business or across the businesses.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.
Q

Okay. And that would mark – that would...

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

With the low point to your question, the low point being the first quarter.

Susan R. McCoy
Senior Vice President-Investor Relations, Leggett & Platt, Inc.

A

That's right.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. Okay. That's helpful. And I realized you guys are still doing some of the initial work on – and with the potential impact could be from the buyers, but can you maybe just remind us of what products are produced in China that are consumed back by the US consumer? Because I know typically you set up your production as produced in the local country, consumed by the local country. So, any color on that would be helpful.

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.

A

Good morning, Bobby. This is Mitch. I'd be happy to comment on that. So, we have 16 plants as we mentioned in China. Probably, the biggest China to US shipping comes in our Home Furniture business. There is some of that that's consumed by our customers in China, converted to finished goods and then comes to the US, as well as a [ph] bit that's direct ship for us from China to the US.

And then, we have 10 automotive plants in China. And as you mentioned, primarily those are local production for the local market. But there is some portion of those goods, particularly motors and actuators that are consumed all around the world, including Europe and the US. So, those are probably the two largest impacts. There's a small operation on the Work Furniture side that has shipments to the US, but Home Furniture and Automotive were probably the biggest exposures.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. That's very helpful. And I guess, lastly for me, Mitch, I think this would probably be back towards you again. But can you maybe comment a little bit of detail on Hydraulic Cylinders? We had another decline in the fourth quarter, maybe. What happened over the last two quarters in that business and then maybe the outlook going into 2020 for that growth area?

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.

A

Okay, Bobby. Sure. Yeah, it's been a bit tough. Sales were really strong in Hydraulic Cylinders from the second quarter of 2018 through the second quarter of 2019, and then really began to fall off rapidly. Our customers who were really the leading forklift producers started forecasting significant demand drops of 15% to 20%, and that's really what we started to see in Q3 and again saw that accelerate in Q4.

We don't have a lot of great data, but the industry data we do see shows that shipments were down over 20% in the fourth quarter, so pretty much in line with where we were and down 13% for the full year, again with that same kind of accelerating decline trend in the fourth quarter. We expect some of this impact to continue as we look into 2020. Probably at this point, we'd see sales year-over-year down in the low-double-digits.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. I appreciate all the detail. Best of luck in 1Q and in 2020.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Thanks, Bobby.

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.

A

Thanks, Bobby.

Operator: Thank you. Our next question comes from line of Keith Hughes with SunTrust Robinson Humphrey. Please proceed with your question.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you. I just have a question on pricing. You talked about the raw material relationship throughout this call with the pricing you're going to be putting under customers coming in April. I think you're talking about spring-related products there. Can you talk about your foam products? What pricing is looking like going into the New Year on that product?

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

It's like steel, it's hard to forecast, but we think that the foam chemical inputs have stabilized. There was a little bit of a continued deflation in the fourth quarter, but at a much lesser rate. So, we think it's near bottom. Keith, there's frankly not a lot of room to go. Coronavirus may have some impact on it, but we think we're at bottom. But we have not seen any signs of recovery. So, in steel, we certainly are seeing an inflationary cycle. We do not have that call on foam chemical inputs.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. And second question, excuse me, on the shape of the year, is the LIFO impact going to be spread out evenly over the year or is that a quarter – is it a quarter-by-quarter or sort of determination based on where inputs have moved?

Susan R. McCoy
Senior Vice President-Investor Relations, Leggett & Platt, Inc.

A

Keith, we're starting the year with a zero LIFO in 2020.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Right.

Susan R. McCoy
Senior Vice President-Investor Relations, Leggett & Platt, Inc.

A

So, if nothing else changes, LIFO, purely as a standalone element, would basically unwind from last year. So, we – it – and quarter-to-quarter has increased a little bit, the first quarter to the second quarter, to third quarter and fourth quarter. We can provide those amounts to you if you need the extra detail.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Yeah. I'll probably get those from you. I'll probably get those from Wendy offline.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

A

Okay. Yeah. I have those...

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

And with the...

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

A

...quarter-over-quarter – we don't, I mean...

[indiscernible] (00:47:01)

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

A

...it's not that we don't know, Keith. We'll update our LIFO as soon as the quarters progress, but it's way too early to make a call.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Yeah. I didn't know if you had accrued something and then make adjustments to the accrual as time went along or just that – it's just that [indiscernible] (00:47:16).

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

A

That's how it works, Keith. But, again, because it's so early in the year, it's too early to make a call on where we think steel, the cost of our steel inventory will be at December 31, and that's – so that – those are the quarterly adjustments we make and then we [indiscernible] (00:47:34) it up at the end of the year.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Final question. On the Home Furniture products, you've been [ph] leading the way the businesses (00:47:41) there, where are you in this progress? You called that out to kind of a negative for the year. I thought that was mostly done. Is there something else you might come up on the radar that you just don't want to do anymore?

J. Mitchell Dolloff
President & Chief Operating Officer, President-Bedding Products, Leggett & Platt, Inc.

A

This is Mitch, Keith. No. You're right. It is substantially complete on the restructuring. We just – when we're looking at the year-over-year comparisons, we will continue to have – show some decline from a revenue standpoint. And as Karl mentioned, we'll face that particularly in the first half of next year as well. But from the point of the restructuring around improving margins and earnings, that's been very successful. Team's done a great job there.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Got that. And finally...

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

And Keith, the kind of final answer to that when you think about steel moving from a deflation to an inflationary environment, you remember the last time we went through this cycle we had a hard time passing through steel inflation in a portion of our Home Furniture business that we no longer participate in, [indiscernible] (00:48:43) side of the business, and in Fashion Bed which we no longer participate in. So, we feel that as we move into the steel inflationary cycle, our company is better positioned and the pricing power that we had years ago we now have again, and with a lot of good work in Home Furniture.

J. Mitchell Dolloff
President & Chief Operating Officer, President-Bedding Products, Leggett & Platt, Inc.

A

Yeah. And from a – I guess going forward just to add on, I think, on Fashion Bed, that exit, it will be particularly as we go into next year. Those are significant dollars. So, just don't repeat that we have [indiscernible] (00:49:13).

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Peter Keith with Piper Sandler. Please proceed with your question.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Hi. Thanks a lot. Good morning, everyone. I didn't want to dig into the auto business, because you guys have actually done quite well there the last two quarters. I think with global market down 5%, and you guys were up 8, and now are you're back to outperforming the industry by over 1,000 basis points. Could you help us to understand what's going on with some of that outperformance and if there's any ongoing continuation of that?

J. Mitchell Dolloff
President & Chief Operating Officer, President-Bedding Products, Leggett & Platt, Inc.

A

Yeah. Sure. Sure, Peter. This is Mitch. Yeah. All we did was taking [ph] that 1 basis point – that 1,000 basis points target away (00:50:08) for us to start killing it.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Yeah. That's how it works.

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.

A

Great timing. But I think we're glad that we did that. I mean as we said before, it really is a long-term target, but we think it's fair to look at ourselves against how the overall market is performing, but again that's a longer-term kind of basis. We did have stronger Q3 and Q4 as we expected, right? We know earlier in the year it was tough to have confidence in us, but we think we came through with what we expected. And I think we continue to see that same kind of optimism in 2020.

Right now, I think we'd see somewhere mid-single-digit improvement year-over-year for 2020 with the market right now flat to down 0.5% or 1%, who knows, I think that will continue to move around a bit. But we continue to have strong gains, content and new products. So, I think we remain very positive on that business.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Okay. Thank you. And then, I wanted to ask a question around Spring and also the adjustable bases. So, the U.S. Spring business accelerated sequentially, but the raw material headwind also picked up notably. And if I remember correctly, I think you did cut prices at the beginning of Q4, so the two-part question would be does that imply that the units of Spring, which I know you don't report anymore, but did that accelerate with the fourth quarter? And then on a related note, why did the adjustable base business pick up so strongly in Q4?

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

I'll take the mattress units. It's really a content story. It's for us to run 62% ComfortCore, as Mitch said, and then the connectivity to increasing adoption of Quantum Edge. So, its dollars are significantly outpacing units. But on the adjustables...

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.

A

Yeah. On the adjustables, yes, a very strong quarter, up over 20%. But it's also you have to look – it was strong, it's been strong for the last few quarters. I think the outsized year-over-year comparison is in part because of a very weak Q4 in 2018.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Okay.

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.

A

So, the run rate was good, but pretty consistent with what we've been seeing for the last few quarters.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Okay. And lastly for me just on – just trying to understand the timing of price cuts and price increases. So, are we correct that it was the beginning of Q4 there was a price cut, now there's another one at the beginning of Q1, and that would be followed by a price increase in April. And I guess, I'm trying to get at is that raw material headwind looks like it could have a – get worse in Q1 and then start to stabilize in Q2 to Q4.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Peter, you're exactly right based on what we know today. You're absolutely accurate.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Okay. Thank you very much, guys.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Thank you, Peter, again.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

A

Thanks, Peter.

Operator: Thank you. Our next question is a follow-up from the line of Bobby Griffin with Raymond James. Please proceed with your questions.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Yeah. Thank you for allowing me to ask one more. I just wanted to quickly touch on the Fabric and Flooring Product segment. How did that perform during the quarter? And as we haven't talked about in a while, but is that business still kind of the same strong cash flow generation business that we used to talk about as before?

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

The answer is yes. It's a really good business that consumes very little capital. Mitch and the team have done a really good job of leaning those businesses out from a working capital perspective, so a greater focus there. But in Flooring's case, it's slow growth. Matter of fact, we would call it probably over time, carpet adoption is probably negative 2% to 3% a year. But its returns on capital employed are very, very high. So, it's the proverbial cash cow. It's a good business. The Fabrics business is somewhat similar to that with the exception of Geo Components, which we continue to invest in and is performing very, very well.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. I appreciate that. Thank you for the update.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

Thanks, Bobby.

Operator: Thank you. Our next question is another follow-up from Susan Maklari with Goldman Sachs. Please proceed with your question.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Hello again.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

Hello, Susan.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Karl, in your remarks, you said that your Aerospace volumes were up 11% in the quarter. Can you just give us any color there? Has there been any disruption as it relates to obviously some of the issues at the OEMs have been having this year with some of their models and how are you seeing the help of that supply chain and how we should be thinking about that for 2020?

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.
A

Susan, I just read numbers. Mitch is going to answer your question.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Okay. Okay. All right. Sorry, we'll let Mitch talk.

J. Mitchell Dolloff
President & Chief Operating Officer, President–Bedding Products, Leggett & Platt, Inc.
A

Okay. I'm giving a shot. Yeah. So, you know what, we actually haven't seen disruption so far. Of course, the Boeing 737 MAX production halt is big news in the industry. But the supply chain, indeed, the supply chain had been struggling to catch up for a long time. And so, while they have stopped production, it really has not impacted us at this point. We're also seeing really strong production on some of the engine platforms that we're on and whenever we service, not only Boeing but the Airbus planes as well. And so, that's really what has been driving our strong growth in the last couple of quarters, particularly on our fabrication facilities in the US and in Europe, and we see that continuing into 2020. I think that right now our outlook is for low-double-digit growth there in Aerospace continuing.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

All right. All right. Very good. Thank you.

Karl G. Glassman
Chairman & Chief Executive Officer, Leggett & Platt, Inc.

A

Thank you.

Operator: Thank you. Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Ms. Watson for any final comments.

Wendy Watson
Vice President-Investor Relations, Leggett & Platt, Inc.

Thank you, everybody, for your attention and questions this morning. And we will talk to you again next quarter.

Operator: Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.