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Leggett & Platt, Inc. (LEG)

Q3 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Leggett & Platt Third 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, Director of Investor Relations. Thank you, Ms. Watson, you may begin.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

Good morning and thank you for taking part in Leggett & Platt's third quarter conference call. I'm Wendy Watson, Director of Investor Relations. With me today are Karl Glassman, President and CEO; Jeff Tate, Executive Vice President and Chief Financial Officer; Mitch Dolloff, EVP, Chief Operating Officer and President of the Furniture Products and Specialized Products segment; Perry Davis, EVP and President of the Residential Products and Industrial Products segment; Susan McCoy, Senior Vice President of Investor Relations; and Cassie Branscum, Manager of IR.

The agenda for our call this morning is as follows. Karl will start with a summary of the main points we made in yesterday's press release. Jeff will discuss financial details and address our outlook for the remainder of 2019. 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 expressed 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 expectations, 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

President, Chief Executive Officer & Director, Leggett & Platt, Inc.

Good morning, and thank you for participating in our third quarter call. First, I want to welcome Jeff Tate, our new CFO, to our team and to introduce him. As most of you are likely aware, Jeff joined Leggett & Platt in September from the Dow Chemical Company, where he most recently served as Vice President and Business CFO for their largest operating segment, Packaging & Specialty Plastics with combined revenue of over $24 billion.

Jeff was a member of the portfolio executive team where he drove financial discipline and provided financial counsel at the strategic and operational levels of the business. His responsibilities included portfolio analysis, value-based strategy development, business risk analysis, short and long-term financial planning, performance measurement and analysis, and in ensuring proper internal controls. In prior roles, Jeff led Dow's global internal audit activities and was Director of Investor Relations.

Jeff is a certified public accountant with a BS in Accounting from the University of Alabama. He is a member of the board of directors of TCF Financial Corporation where he serves as Chair of the Finance Committee and as a member of the Audit Risk Management and Compensation and Pension Committees. He also previously served on the Public Company Accounting Oversight Board Standing Advisory Group. Jeff brings tremendous strategic and financial capabilities to Leggett. He is well-aligned with our culture and is a strong addition to our senior management team. Welcome, Jeff, we are excited you are here.

I also want to recognize Perry Davis. As I mentioned last quarter, Perry is retiring in early 2020 after nearly 40 years with Leggett & Platt, and this will be his last earnings call as a participant. We will miss you, Perry, and I suspect that you won't miss participating in these conference calls going forward.

We have several items to highlight in our third quarter results. Yesterday, we reported third quarter sales growth of 14%, third quarter EBIT growth of 16% and adjusted EBIT growth of 19%. Third quarter earnings per share were $0.74 and adjusted EPS was $0.76, a 15% increase over third quarter 2018 adjusted EPS.

Operating cash flow in the quarter was a strong $213 million. Adjusted working capital was a percent of annualized sales for the quarter improved at 10.7%. Our results show the focus our teams have on cash generation. Your efforts are much appreciated. Third quarter sales were $1.24 billion. Growth from ECS and other smaller acquisitions was 16% in the quarter. Organic sales were down 2%, 1% from volume and 1% from deflation and a negative currency impact.

Our Automotive, U.S. Spring, and Work Furniture businesses had solid third quarter sales growth offset by the planned exit of business in Fashion Bed and Home Furniture, which reduced sales 4% and weak trade demand for steel rod and wire. Absent declines from exited business, volume was up 3%. Our bedding businesses continue to perform well with U.S. Springs sales up 6% in the quarter. Finished mattress units were up 28% in the third quarter including year-over-year growth at ECS. Automotive sales were up 8% in the quarter and Work Furniture was up 6%.

Third quarter 2019 earnings per share were $0.74. This included $4 million of restructuring related charges that reduced earnings $0.02 per share. Third quarter 2018 EPS of $0.67 included a $0.01 per share benefit due to the Tax Cuts and Jobs Act. Excluding these items, adjusted third quarter earnings of $0.76 were up $0.10 from adjusted 2018 third quarter earnings, reflecting higher EBIT and a lower effective tax rate, partially offset by higher interest expense.

EBIT benefited from the ECS acquisition even after $12 million of amortization expense, lower raw material cost, including a LIFO benefit and improved earnings performance in furniture products. Adjusted EBIT margin increased 50 basis points to 11.9%, and adjusted EBITDA margin increased 130 basis points to 15.8%.

The restructuring activities we initiated in the fourth quarter of 2018 in our Home Furniture and Fashion Bed businesses are substantially complete. With the segment's adjusted EBIT of $12 million and adjusted EBIT margin up notable 470 basis points in the quarter, we are already seeing a positive impact from a lower fixed cost and improved pricing.

We had further restructuring in the third quarter from the closure of a small machinery facility in our Residential Products segment and a wire-drawing facility in our Industrial Products segment. We now expect full year restructuring-related charges of $14 million, $7 million of which is noncash.

We also wanted to update you on the automotive market. Year-to-date, production in the global markets is down 6% and is expected to be down approximately 6% for the full year. Our Automotive business grew 8% versus third quarter 2018, exceeding global market growth by over 1,000 basis points. This year, we should exceed market growth by 600 to 700 basis points.

We remain confident in our continued strong performance. Ongoing disruption of the global markets makes it difficult to predict our relative performance with precision. Accordingly, we are moving away from our specific goal of exceeding market growth by 1,000 basis points, although we still expect to significantly outperform the market over the long term.

In mid-October, we received more positive news from the United States mattress industries anti-dumping petition on imported Chinese mattresses. The Department of Commerce made a final determination that Chinese mattresses are being sold at prices that violate the US trade laws and imposed final anti-dumping duties that range from 57% to 1,732%. Importantly, approximately 90% of Chinese mattresses are now subject to anti-dumping duties in excess of 160%. We expect the United States International Trade Commission to make a final determination in the anti-dumping matter no later than the first week of December.

I'll now turn the call over to Jeff.

Jeffrey L. Tate

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

Thank you, Karl, and good morning, everyone. As previously mentioned, operating cash flow was a strong $213 million in the third quarter, an increase of $86 million versus the same quarter last year. Another quarter of keen focus on working capital levels was reflected by our quarter and adjusted working capital as a percentage of sales at 10.7%, an improvement versus 12.4% in the second quarter and 12% in the third quarter of 2018. We now expect our full year operating cash flow to exceed $550 million.

Demonstrating our ongoing capital discipline, we're reducing our full year capital expenditure estimate from $180 million to $160 million, and dividends still require $205 million for the year. Through the third quarter of 2019, we've returned over $180 million of offshore cash and expect to bring back an additional $50 million before year end. This significantly exceeds our original full year expectation to bring back $170 million of offshore cash.

We ended the quarter with debt at 3.15 times our trailing 12-month pro forma adjusted EBITDA, an improvement over second quarter's 3.45 times. As we announced yesterday, we are raising our full year earnings per share guidance range for 2019 to $2.40 to $2.55 from a range of $2.30 to $2.50, including approximately $0.08 per share of restructuring-related costs. Accordingly, full year adjusted earnings per share is expected to be $2.48 to $2.63. Based upon this guidance framework, our full year adjusted EBIT margin range should be 11% to 11.3%.

Earnings per share guidance assumes a full year effective tax rate of 22%, full year depreciation and amortization of $200 million, net interest expense of $85 million, and fully diluted shares of 136 million. We are narrowing our full year sales guidance expectations to $4.7 million to $4.8 billion or up 10% to 12% over last year. Acquisitions should add 15% year-over-year growth.

We expect our organic sales to be down 3% to 5%, including a 3% reduction from planned exited business in Fashion Bed and Home Furniture. We also expect full year sales growth in U.S. Spring, Automotive, Work Furniture, Adjustable Bed and Aerospace.

And finally, as I close, we invite you to our Investor Day on Monday, November 18 in New York City. We will webcast the event, which will take place from 8:30 AM to noon Eastern Time. The webcast and slides will be available on the Investor Relations section of our website. Please contact Investor Relations for more information and to sign up. With those comments, I'll turn the call back over to Wendy.

Wendy Watson

Director-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. In order 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. Jessie, we're ready to begin the Q&A session.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now be conducting the question-and-answer session. [Operator Instructions] Thank you. Our first question comes from Bobby Griffin with Raymond James. Please proceed with your question.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Good morning, everybody. Congrats on the quarter and I appreciate you taking my questions. I guess, first, Perry, congrats on retirement, an impressive career. I've really enjoyed working with you over the years, so I wish you nothing but the best going forward.

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.

A

Thanks, Bobby. I appreciate that.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

And Jeff, welcome to the company. I look forward to meeting you at the Investor Day and getting to work with you as well, as we move forward.

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

A

Thank you, Bobby. Looking forward to it.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

So my first question is really just kind of more of a high level question on bedding and the shift that's going on from open innersprings into the ComfortCore pocketed units. Can you maybe update us on where you see the runway of that going in the US? Is there still room for further penetration? And what's the penetration today versus the penetration of pocketed coil in Europe for instance?

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.

A

Well, Bobby, it's – I would probably be a poor one to ask, it's exceeded my expectations for sure over the last few years. In the third quarter, for Leggett, our growth in ComfortCore was up 20, a little over 22% year-on-year. So now, as a percentage of total innersprings in our business, if you look at comp recorded, it's about 60% run rate in the third quarter.

And of that, ComfortCore – our Quantum Edge products are those products that have basically replaced foam with springs. As a percent of ComfortCore, Quantum Edge and Edge enhanced products are about 48% of the total ComfortCore. So it's almost half at this point, well beyond what I thought. I thought at one point, we might top out at about 40%. That's not the case. And more and more customers are seeing the value both in their manufacturing efficiencies and in the true benefits that can be demonstrated to the consumer in those spring-enhanced products.

By the way, it's not inconsequential also that we're seeing more and more of that product in compressed roll mattresses as a built-in Edge support. It truly does provide a benefit that the customer can readily see.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. Is there still a few large customers that haven't adopted all the way to Quantum Edge yet?

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.

A

There are. We'll see more introductions as we go forward into January at the Vegas market. And we expect that to further grow. It just makes too much sense from a manufacturing standpoint, from a compression and packaging standpoint, and from the consumer benefit.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. And then lastly for me, I was hoping – maybe just to get a little more detail around the moving parts with the updated full year guidance, we saw sales tick down slightly at the midpoint but EPS actually come up versus prior expectations. Can we maybe unpack a little bit of what's first driving the sales reduction at the midpoint? Is it further incremental deflation, uncertainty around auto or uncertainty around external sales for wire, and then maybe connect that on what's driving the EPS a little bit higher as well?

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

A

Yeah. Good morning, Bobby. It's Karl. Really the changes since we last issued guidance, which as you know was the end of July, sales midpoint, that slight reduction uncertainty is really the key word. Deflation has become more apparent. Scrap has traded off more aggressively since we issued last guidance than we expected. So, we're starting to see some reduced selling prices first in the Industrial segment that will ultimately move to Residential. That's actually good for margins because of delayed lag. So it's kind of a negative-positive, if that makes any sense.

And as we continue on, you hit it, the IHS data on automotive continues to reduce at kind of an accelerated rate. We think the majority of that was caused by the GM strike. So, from our data point, we would have had the impact of the strike for just a couple weeks in the third quarter, certainly all of October in the fourth quarter. And even though the auto workers have ratified the election, that we don't know to what degree that the supply chain will ramp up. So, there is some uncertainty, and with that slight down shift, we've allowed ourselves a little bit of cushion for that uncertainty.

As it relates to EPS, we're dealing with a lower than expected tax rate. You'll notice that our third quarter tax rate came in very favorably to forecast. And I really need to call out our people. They did a wonderful job of bringing back this offshore cash at a lower rate than we originally expected. So, that drove lower tax rate, lower interest expense. Our people have done a great job of cash generation. So, we have more cash, lower interest rates from a macro perspective, so that's driving part of it. We're also seeing improved margins again from the deflation and from the terrific job that our people have done on the restructuring of the Furniture Product segment. So, roll that out altogether, slight downdraft on top line. Again, it's just a testament on macro uncertainty and a pickup in EPS for all the reasons I listed.

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

I appreciate the detail, Karl. That's very helpful and I'll jump back in the queue. Best of luck in the fourth quarter.

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

Thank you, Bobby.

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

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

Good morning, Leggett team, and Perry, best of wishes in retirement.

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.
A

Thank you, John.

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

Let's see. So, could we maybe start, either Perry or Karl, with where ECS is tracking on a ECS to ECS year-over-year performance and maybe since you've acquired year-to-date? And then comment on if pricing deflation has influenced that revenue figure at all. How is it tracking relative to expectations?

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.
A

Well, John, yes. In answer to your question, it has deflation. It definitely has impacted top line there significantly. We kind of knew at the time of the acquisition in the months leading up that we were looking at some pretty historically high chemical input costs and that those were likely to fall over time. But more importantly, we wanted to look at what ECS could generate in terms of margins through that downturn, and as that began to turn around and we became comfortable with our ability to recoup those costs, when and assuredly, they will go up at some point over time, it's a commodity.

But we became really comfortable with the pricing power in the marketplace, with the uniqueness of the product offerings that they had, and the position they had in the value chain. So there's a comment in our release with regards to a 28% increase in their finished mattress products year-on-year. That's a total of – if you took the historical 2018 ECS and the Leggett pieces that were produced in terms of finished mattresses and then you just look at this year, the total amount is up 28%. So that's certainly met our expectations in terms of double-digit growth. It's just kind of hidden a little bit, because of the massive deflation impacts that we've seen.

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

Okay, so...

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

A

And I would add, John...

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

Q

Yeah, go ahead.

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

A

I would only add that the things that have most surprised us about ECS is certainly the rapid deflation that Perry made reference to. The other thing is, really kind of goes back to Bobby's question. And the incredible rate of adoption of hybrid compressed mattresses in every channel of distribution in this country has been really remarkable. So, that element of ECS has exceeded expectations. We are really, really pleased with the way ECS is tracking.

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

Q

So, I don't know the Leggett finished mattress pieces from a year ago, but is the bottom line is ECS standalone is still tracking at a double-digit kind of finished mattress figure year-over-year, if I understood that correctly?

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

A

That's correct. The Leggett finished mattresses of a year ago, while important to us, were relatively insignificant to the total ECS number.

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

Q

Okay. Rod and wire was down I think 12% in demand. And I was wondering if you could tell us what areas our customers are weak there, and what the prospects are there kind of near-term?

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

A

Yeah, John, it's trade. It's macro uncertainty in the United States. It's kind of all markets. You remember that about 30%, Perry, it might even be a smaller number than that of our total production gets sold into the open market. And it's just general softness in all of those industrial markets.

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

Q

Good. And I saw that hydraulic sales were down 12%, but it looked like pricing was up. Is there anything going on with that business which I believe was newly acquired?

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

A

John, Perry and I are looking forward to Mitch talking. Go ahead, Mitch.

J. Mitchell Dolloff
Chief Operating Officer, Executive Vice President & President-Specialized Products and Furniture Products, Leggett & Platt, Inc.

A

I thought I was going to escape the whole call. Thanks for bringing me in the loop, John. Yeah, it's really more of a industry phenomenon there. We saw the global industrial truck unit volumes, which includes material handling equipment which is a core market for PHC, were down oh 5.4% year-over-year in Q3 and down almost 8% in the second quarter. And our customers there, which are generally the leading forklift producers, are seeing demand drop 10% to 15% in North America and 15% to 20% in Europe. So, we're seeing those declines in our business early as the supply chain catches up to the long lead times that we had in 2017 and 2018 when volumes were up over 15%.

So, we're going from an environment where we couldn't keep up to now one where we see pretty significant declines in demand. So, that's really the phenomenon there. Interestingly, our earnings were roughly flat because last year, we were struggling to pass through raw material cost inflation. So, that's what relates to your pricing comment. Basically, we've just caught up our pricing to the material cost which sort of offset the volume declines that we had this year. So, we're taking action to reduce headcounts and take other cost out in response to the volume declines that we see coming.

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

Q

Okay. Thanks. And my last question is on when will we anniversary the drag from exiting the Fashion Bed and parts of Home Furniture? And the EBIT increase that was called out in Furniture was just quite good. I know it said pricing and costs were down, but is this merely a function of exiting these businesses or the remaining legacy businesses stronger in addition to that?

J. Mitchell Dolloff
Chief Operating Officer, Executive Vice President & President-Specialized Products and Furniture Products, Leggett & Platt, Inc.

A

I think it's both, John. I think that we're benefiting from exiting what was low-margin business but also benefiting from making sort of structural improvement in that business. So we have better pricing discipline. We've taken excess capacity offline and we've taken significant cost out both from a manufacturing standpoint but also from a pure overhead standpoint. So we think that the restructuring has had its intended effect, but also put us in a position to be more stable and more profitable going forward.

To your anniversary, I think our Home Furniture, we probably see that we're – don't have full year this year of some of the business that we exited, so we'll see a little bit impact from a sales standpoint next year, but I think we'll see continued margin improvement. And then from a Fashion Bed standpoint, we're pretty well ramped down by the end of the third quarter from a sales standpoint. So I'm trying to – let me remember here. So we basically have no sales repeating next year. We have a small hospitality business that we're looking to exit, but that's about $15 million. So I think our 2019 sales, there will be $65 million to $70 million, and so, those won't repeat next year.

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.

A

John, this is Perry

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

Q

Great.

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.

A

...there is one additional point. You had asked as part of your original question and I just want to make sure that we answer it, with regard to Europe and ComfortCore. So as I said, ComfortCore in the U.S. for Leggett is approaching 60%. Bear in mind in the U.S., we play in all the different areas of the value chain pretty strongly whether it's promotional to premium; in Europe, not so much the case. We tend to trend more towards the upper end or the mid-upper end part of the market, so our ComfortCore, as a percentage of total innersprings in Europe represents a higher percentage of our sales. There are a lot of low cost Bonnell and open-coil innersprings in that market that are imported. And we don't tend to play so much in that market and historically have not. So ComfortCore would represent an even higher percentage of our sales in Europe.

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

Q

Great. Thanks and good luck.

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

A

Thanks, John.

Operator: Thank you. Our next question is from Daniel Moore with CJS Securities. Please proceed with your question.

Stefanos Crist
Analyst, CJS Securities, Inc.

Q

Hi. Good morning. This is Stefanos Crist calling for Dan.

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

A

Good morning, Crist.

Stefanos Crist
Analyst, CJS Securities, Inc.

Q

In Residential, poor weather has impacted a lot of companies in Q2, particularly in housing, and many of them have seen a comeback. Do you think your customers experienced a shift in demand from Q2 to Q3 and what are you seeing so far in Q4?

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.

A

Yeah, I think in certain businesses, Crist, it has had an impact. We've seen a little bit of challenge in terms of for instance in our flooring products group with volumes. But that's a factor. A lot of that product gets sold into multifamily housing also. Look, amongst our major customer groups, we have seen a bit of a negative impact on volumes, some of that which you likely could lay on to the weather although we normally don't like to do that, but yes, definitely in a few of those businesses, we would see that.

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

A

And there probably was some impact in our geo components business. But again, to Perry's point, Crist, we generally don't talk much about weather. In the sum total of things, it's not significant.

Stefanos Crist
Analyst, CJS Securities, Inc.

Q

Got it. Thanks. And then, how much of a remaining volume headwind do you expect from divested businesses in Q4?

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

A

Stefanos, it's another 4% down in volume from the exited businesses in Q4.

Stefanos Crist
Analyst, CJS Securities, Inc.

Q

Another 4%.

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

A

Basically the same as Q3.

Stefanos Crist
Analyst, CJS Securities, Inc.

Q

Yeah. Got it. All right. Thank you. And that's it for me.

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

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you. Couple of questions on slide 14, your assumptions for the year. Specifically in Residential Products, you talked about flat organic sales, which would mean, assuming it's a rough math, kind of another negative organic number in the fourth quarter after a pretty solid number here in the third. Can you talk about what's driving that down? Sounds like ECS may be a part of it but just kind of the nuts and bolts would be great.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

Oh, yeah. Sorry, Keith. It's Wendy. We expect to continue to see nice growth in U.S. Spring and Residential in the fourth quarter, but we've seen softness in a lot of our other businesses. Flooring has been down this year and we expect to see that continue. They've got some deflation in those numbers, too. So that's the primary driver of flat organic sales in the fourth quarter in Resi.

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

A

And deflation is a bigger issue...

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

Yeah.

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

Correct.

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

...in the fourth quarter, too, as that continues to roll through.

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

Yeah. Keith, kind of think to Susan's point, think of deflation in 3Q having a greater impact in the Industrial and in 4Q starting to have an impact in Residential.

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

Yeah.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc. Q

Okay. And specific to ECS, you talked about it a bit earlier. If you look at your projections for 2019, with the EBIT dollars at ECS, how would they compare to the EBIT dollars in 2018? Not talking about margins, but just dollars.

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

EBIT dollars would be up compared to the original projection, I think. But Wendy is going to test me on – check me on and probably test me.

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

Yes.

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

Pretty.

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

Yeah, pretty close. I mean there is...

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Not projections, but 2018. How is it doing versus? And what I'm trying to get to is you've seen deflation in the business, but of course, their inputs have gone down as well. I'm just trying to capture how the spread on this works.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

It's going to be flat to...

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

A

Flattish.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

Yeah, it's going to be flattish. With the parts that'll be down, you could attribute absolutely to deflation.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. So when ECS sees deflation in the end user market, so they're not seeing deflation in the inputs coming in as well?

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

Yes. In the chemicals?

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

In the chemicals, yeah.

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

A

Yes.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

Yes.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. So, I mean there's a lot of growth in their business, it sounds like in terms of units. So have their just dollars not gone up notably in 2019 versus 2018?

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

In that, well...

Perry Davis
Executive Vice President & President-Residential Products and Industrial Products, Leggett & Platt, Inc.

A

I think, Keith, that's generally true. The number of pieces in the demand environment we've seen in terms of this sheer numbers, not only looking at mattresses, but in some of the other important parts of their business in finished foam products generally, toppers, pillows, those types of things. Yes, we've seen tremendous demand growth there.

We have actually and had certain points over the last quarter, where we have throttled back some of our order acceptance because we just simply had some capacity concerns, which we're addressing as we speak. We've added lines for additional mattress production. We've changed some flow layouts and things in order to get better efficiencies within our manufacturing operations, but again that handicap when you look at it in terms of dollars by the overall pretty severe deflationary environment. Again, a little under half at last count of our mattress volume in that space was under contract. So, we see – much as we do in our steel-related businesses, we see kind of a delayed deflation picture as we take those decreases down. And they don't all happen at once, they happen over time because we saw an incremental step-down in our raw material inputs.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

And just, Keith, we saw in the third quarter, while sales dollars were up, that was even after a roughly 11% drag from deflation.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Thank you. And that's all for me. Thanks.

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

Robert A. Friedner
Analyst, Piper Jaffray & Co.

Q

Hey. Good morning, everyone. It's actually Bobby Friedner on for Peter. Thanks for taking our questions, and nice results. Just want to discuss gross margin, so now we've seen two quarters with nice year-over-year improvement. I was hoping if you could discuss in a little more detail the different bucket there contributing to the improvement. And as we look to Q4 and early 2020, how do you think that's sustainability of gross margin expansion? Thanks.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

Oh, hi, Bobby. This is Wendy. It's really the drivers behind our gross margin improvement have to do with volume growth and are more profitable businesses, the puts and takes we talked about from exiting the low margin business. And then, the reverse lag in LIFO benefit we're seeing from deflation.

And then, relative to 2020, we certainly won't guide for 2020 until we get to February and we announce a full year earnings. But we're – as Mitch discussed, we will continue to see some of the benefit in our Home Furniture business from the improvements we're seeing, and we expect to see those improvements ongoing. And as we see our more profitable business is doing well, we would be pleased with that performance.

Robert A. Friedner
Analyst, Piper Jaffray & Co.

Q

Okay. And I guess just as a follow-up, still prices still seem to be running down significantly year-over-year. Should we expect continued LIFO benefits in Q4?

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

Yeah. Our full year estimate is $24 million, so we would expect a roughly $6 million LIFO benefit in the fourth quarter. As you know in the fourth quarter, we true it up to actual, so that $6 million is an estimate, it'll be wrong but we'll let you know what the actual is, when we report for the full year.

Robert A. Friedner
Analyst, Piper Jaffray & Co.

Q

Okay. Thanks a lot.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

A

You bet.

Operator: Thank you. It appears we have no additional questions at this time. So I'd like to pass the floor back over to Ms. Watson for any additional concluding comments.

Wendy Watson
Director-Investor Relations, Leggett & Platt, Inc.

Thank you everybody and we will talk to you next quarter.

Operator: Ladies and gentlemen, this does conclude today's teleconference. We thank you for your participation, and you may disconnect your lines at this time.