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Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Leggett & Platt, Incorporated Fourth Quarter 2018 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 fourth quarter conference call. I'm Wendy Watson. With me today are Karl Glassman, President and CEO; Matt Flanigan, EVP 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; and Cassie Branscum, Manager of IR.

The agenda for our call this morning is as follows: Karl Glassman will start with a summary of the major statements we made in yesterday's press release, Matt will discuss financial details and address our outlook for 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 of 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 today – 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.

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 fourth quarter call. First, I would like to thank our dedicated fellow employees around the world for your efforts during this past year. They are very much appreciated. We are pleased with our 2018 operational performance, despite the challenges we faced in some of our businesses, most notably Home Furniture and Fashion Bed.

Fourth quarter sales increased 6% to $1.05 billion on flat volume. Raw material related price increases, net of currency impact added 3% to sales growth and acquisitions also added 3%. Fourth quarter earnings per share from continuing operations were $0.39. This includes several items outlined in yesterday's press release that amount to a $0.23 per share reduction in earnings. Excluding these items, adjusted fourth quarter earnings increased 5% to $0.62 per share from $0.59 last year. This increase is primarily due to improved metal margins in our Steel Rod business.

In 2018, sales grew 8% to $4.3 billion with organic sales up 6% from a combination of 3% volume growth and a 3% benefit from raw material related price increases and currency impact. Acquisitions, net of divestitures completed in 2017 added 2% to sales growth. Full year sales benefited from ongoing content gains and new program awards in Automotive, market share gains and continued shift to ComfortCore and Quantum Edge innersprings and U.S. Spring, and strong growth in Adjustable Bed, Work Furniture, and Aerospace. These improvements were partially offset by declines in other businesses, primarily Home Furniture, Fashion Bed, and Flooring Products.

Full year earnings per share from continuing operations increased to $2.26 from $2.14 in 2017. Earnings from 2018 include the fourth quarter $0.23 per share reduction just mentioned, and a third quarter $0.01 per share benefit related to the Tax Cuts and Jobs Act for a net reduction of $0.22 per share. Full year 2017 earnings included a $0.32 per share net reduction, primarily from cost associated with the Tax Cuts and Jobs Act.

Adjusted full year earnings per share increased 1% to $2.48, adjusted EPS benefited from improved metal margins at our steel mill and higher sales. These improvements were largely offset by higher steel costs, including LIFO expense and the lag associated with passing along ongoing inflation. In 2018, we made some important strategic moves that should reinforce an achievement of our long-term financial goals. In January, we acquired Precision Hydraulic Cylinders, a leading global manufacturer of engineered hydraulic cylinders primarily for the materials handling market. PHC is our first business in the hydraulic cylinder industry, a market we identified through our sales of competition analysis.

In November, we announced the acquisition of Elite Comfort Solutions and we have completed the acquisition last month. ECS is a leader in proprietary specialized foam technology, primarily for the bedding and furniture industries. The purchase price was $1.25 billion and was financed through an expansion of our commercial paper program and the issuance of a $500 million five-year term loan with our current bank group.

Through the ECS acquisition, we have gained critical capabilities in proprietary foam technology along with scale in the production of private-label finished mattresses. Our combined expertise in spring and foam technology make us the leading provider of differentiated products for the global bedding industry. ECS' annualized sales for the fiscal year ended September 2018 were $611 million, and we expect ECS to add approximately $675 million to sales growth in 2019. ECS is in our new specialty foams business unit within the Residential Products segment reporting to Perry.

As previously discussed, we continued an in-depth analysis of our Fashion Bed and Home Furniture businesses and initiated restructuring activity late last year. Restructuring-related charges in 2018 were $16 million, and we expect an additional $17 million of charges in 2019. The restructuring activity should be substantially complete by the end of this year. In 2019, we expect these acquisitions and Leggett initiatives to drive sales growth and increased margins. Matt will discuss our guidance for the year later in the call.

Finally, the quarterly slide decks that we posted to the Investor Relations website contains unit growth rates for innersprings and boxspring pieces within our Residential Products segment. Because of content gains, including strong growth of our ComfortCore innersprings, and other higher dollar value units, dollar growth and unit growth have become increasingly disconnected. Accordingly, beginning in the first quarter of 2019, we will stop reporting unit growth for innersprings and boxsprings. We will continue to provide dollar growth as we do for our other business units.

With all – I'll now turn the call over to Matt.

Matthew C. Flanigan

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

Thank you, Karl, and good morning, everyone. In 2018, we generated operating cash flow of $440 million, which once again included our typically strong fourth quarter cash flow performance. We continue to have a strong and sharp focus on working capital management and we ended the year with adjusted working capital as a percentage of sales at 10.6%. We repatriated $141 million of offshore cash in the fourth quarter, bringing our full year total to $314 million. In November, we declared a $0.38 per share quarterly dividend, a 6% increase versus the fourth quarter of 2017. Our dividend payout, as a percentage of adjusted earnings, was 60% for 2018 at the top of our target dividend payout range of 50% to 60%.

Beginning in 2019, in conjunction with the increase in leverage from the ECS acquisition, we announced a modest change in our dividend payout target to approximately 50% of adjusted earnings. We expect to continue increasing the dividend as we repay debt associated with the ECS acquisition. At Friday's closing price of $40.97, our current yield is 3.7% which is one of the highest yields among the 57 companies that comprise the S&P 500 Dividend Aristocrats.

For the full year, we've repurchased 2.6 million shares of our stock at an average price of $43.10 and issued 1.2 million shares, primarily for employee benefit plans and stock option exercises. During the year, we acquired PHC and two small geo component operations. We also continued investing capital to support organic growth opportunities, primarily in Automotive and Bedding. We increased the borrowing capacity under our commercial paper program from $800 million to $1.2 billion in connection with the funding of the ECS transaction.

We ended the year with debt at 1.9 times our trailing 12 months adjusted EBITDA. After completing the ECS acquisition in January, our debt levels increased as expected to approximately 3.5 times. We are committed to maintaining a strong investment grade credit rating and expect to deleverage to a target ratio of debt to trailing 12 months EBITDA of approximately 2.5 times by temporarily suspending share repurchases, reducing other acquisition spending, 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 one-third of the S&P 500 over the long-term, which we believe, will require an average TSR of 11% to 14% per year. While our recent performance has not met this target, we continue to strongly believe, our disciplined growth strategy and prudent use of capital will support achievement of our top-third goal over time.

Sales growth in 2019 will benefit significantly from the ECS acquisition. We also expect sales growth in Automotive, U.S. Spring, Aerospace, and Hydraulic Cylinders, partially offset by planned declines in Fashion Bed and Home Furniture related to restructuring efforts and from less promotional activity in Adjustable Bed. 2019 sales are expected to be $4.95 billion to $5.1 billion, or up 16% to 19% over last year. ECS should add approximately $675 million to sales. In addition to ECS, same location sales growth is expected to be flat to up 3%.

Earnings per share are expected to be $2.35 to $2.55, including approximately $0.10 per share of restructuring-related cost. Therefore, adjusted EPS is expected to be $2.45 to $2.65, reflecting slightly higher organic sales and moderating steel inflation, partially offset by higher tax rate. As we have previously stated, the ECS acquisition is expected to be neutral to EPS in 2019. EPS guidance assumes a full year effective tax rate of 24% versus 20% in 2018.

This higher rate reflects the non-recurrence of some valuation allowance releases we benefited from in 2018, a smaller expected stock compensation benefit in 2019, the impact of TCJA executive compensation limits, and tax implications from higher interest expense due to the financing of the ECS transaction. We expect 2019 depreciation and amortization to approximate $210 million, net interest of approximately $95 million, and fully diluted shares of $136 million.

Based upon this guidance framework, our 2019 full year adjusted EBIT margin should be 10.8% to 11.2%. While we do not issue specific quarterly guidance, we expect revenue growth rates to be somewhat consistent across the quarters in 2019. We expect adjusted margins in the first quarter to be lower than first quarter last year, in part due to the purchase accounting for acquired ECS inventory. And, we expect year-over-year adjusted margins to be flat to slightly improving by the second half of the year.

Cash from operations should approximate $550 million in 2019. Capital expenditures should be near $195 million for the year, and dividends should require $205 million of cash. Our dividend payout ratio for 2019 is anticipated to be above our target of approximately 50% of adjusted earnings. Our long-term priorities for use of cash remain; one, organic growth involving capital expenditures and working capital investments; two, dividends; three, strategic acquisitions; and four, share repurchases. As previously stated, we will temporarily suspend share repurchases, reduce acquisition spending, and prioritize debt repayment after organic growth and dividends.

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'll be glad to answer any of 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're welcome to re-enter the queue, and we will answer those questions as well.

Michelle, 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 Credit Suisse. Please proceed with your question.

Q

Hi. This is Chris Katala on for Susan. Thanks for taking our questions. First question is just on the Industrial Products segment, you've been able to realize a significant amount of pricing in the second half of 2018. So, I was just wondering how much additional pricing are you expecting this year and what benefit could that have to your margins?

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

A

Yeah. Chris, we – this is Perry Davis. We definitely saw a run up last year in both scrap, and particularly in rod pricing. The – we feel at this point in time that we are pretty much at the peak. We, in fact, saw some slight deflation in scrap inputs in January, which is a little uncommon. I don't believe we've seen a January decrease in scrap pricing since 2006, but overall, we believe that over the next few months, our input cost and rod prices will remain relatively constant.

Chris Katala

Q

Okay. Thanks. And then, just for my second question, does your full year guidance, that include the impact of a full 25% tariff environment, and are you able to quantify what the incremental headwind would be between the 10% and 25%?

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

A

Chris, it's Karl. The answer to that is no. We don't know what to expect as it relates to tariff. We assume that if the tariffs are in fact increased to 25%, we'll pass them through. But, in our top line forecast, they do not include the expansion of tariffs – tariff activity. We just don't know.

Q

Okay, that's it. Thanks for that.

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

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Yes. Thank you. Good morning, everybody, and I appreciate you guys taking my question.

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

A

Morning, Bobby.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

First, I want to touch on the Automotive segment, and kind of see what the outlook is assuming your guidance for 2019, and how kind of the program wins trended in 2018?

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

A

Good morning, Bobby. This is Mitch. I will take that one. Of course, our Automotive business continues to perform really well, and our long-term outlook hasn't changed. Our strong pipeline of awarded future program continues to give us confidence in our goal of beating the vehicle production growth by a 1,000 basis points. We've had double-digit increases in our new awards every year since I've been counting this since 2011, overall CAGR of over 15% since that time. So, we think, the visibility that we have there, it really gives us a strong case to stand by our goal. For 2019, production is forecast to be up about 1% globally, and about 0.6% in the major markets. And we look at what we have, net of coming online versus programs ending, we still feel confident in our double-digit target.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. Does the production forecast assume any type of stimulant in for China automotive demand that they announced recently?

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

A

I don't know. I think it's kind of hard to tell with a variety of factors that are happening in China. Certainly, people have been hopeful that there is some kind of incentive that kicks in, but you still have some general economic malaise there, and certainly some impact from the trade disputes. So, I think, the China forecast for 2019 is a little bit better. So, it was down 3.5% in 2018, and the forecast that I see, shows it up 1.7% in 2019. So, by historical terms, that's still not – still fairly low for China.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. I appreciate that detail. And then lastly for me, just from a modeling standpoint, is there any help you guys can offer on the sales wind down of Home Furniture and Fashion Bed. I know Fashion Bed was probably roughly at $200 or so million business last year and Home Furniture, half that business is motion and half stationery and that was probably around $370 million combined. How should we think about those two businesses in 2019? I understand they're going to be smaller, but from a modeling standpoint, any help would be greatly appreciated.

J. Mitchell Dolloff

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

A

Okay, Bobby. This is Mitch again. I'll take a shot, and Wendy can jump in if there's additional detail. But, let's talk about Home Furniture first, I think that we're making good progress there. We got a lot of good activity underway in terms of passing along price increases or shedding low margin business. We made good project – progress transferring production to our Chinese operations to take advantage of lower input cost, and we've been reducing overhead and operating costs, and we'll move forward to further reduce excess capacity.

I think you're starting to see that performance stabilize in the fourth quarter. We're moving aggressively and expect to complete the implementation largely by the end of the first half of the year. So, for 2019, in that business, I think, we do see some shrinkage of sales, think about it in terms of like mid-single digits, but with increased – significantly increased earnings power on that side. On the Fashion Bed side, you will see more significant sales declines as we continue to trim the product categories there and really focus on monetizing inventory. I would think about the sales decline there being closer in the 20% to 30% range with probably very little earnings impact.

Bobby Griffin

Analyst, Raymond James & Associates, Inc.

Q

Okay. I appreciate all that detail. I'll jump back in the queue. And, best of luck this year.

Karl G. Glassman

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

A

Thanks.

J. Mitchell Dolloff

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

A

Thank you, Bobby.

Operator: Thank you. Our next question comes from the 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 just have two questions, I guess, first 2019 guidance, is there anything assumed around timing or rate on the antidumping situation?

Karl G. Glassman

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

A

John. No. We continue to be optimistic, have every reason to be optimistic. The timing with the government shutdown has pushed out until end of May for the early determination. We do expect some positive impact, but don't know how to quantify it. So, we just were – we kind of ignored it from a guidance perspective.

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

Q

Okay. Thank you. And then, as follow-up, could you comment, one on the Flooring weakness, what you saw both in the fourth quarter and maybe for the year last year and what you're seeing right now? And then, any way appreciate the comment about not giving us units, like on boxsprings, and obviously, they're in steep decline, but how do we think about the dollar, maybe the net dollar impact of gaining units on the Adjustable side, but then losing the boxsprings, what's that net trade? Thank you.

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

A

I'll take the last one. Remember, those two are in different segments. So, they're reported differently with adjustables being in Furniture and boxsprings being in a subset of U.S. Spring in Residential. But, it's – I guess, the one word is significantly positive. The average unit selling price of an Adjustable Bed is in the $200 to $300 range, higher in some cases, and the boxspring is probably $10 to $15. Remember that's just a steel grid structure. So, that trade is a good trade. There's other things going on in that there are a fewer bed frames sold because of the advent of box beds and platform beds. When there's fewer boxsprings, there's – fewer bed frames and boxsprings correlate. So, there's just a lot going on in those markets as relates to flooring weakness, go ahead Perry.

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

A

Yeah. John, looking at Q4 and – there were a few factors that kind of played into a little bit of a downdraft. First of all, we had some customers, and then some secondary customers, which is secondary, I mean, down the value chain. So, during the fourth quarter, Mattress Firm went through a where they – period of time, where they liquidated some excessive inventories. We also had that occur amongst some of our major customer groups during the fourth quarter, and then, also we feel like based on the conversations we've been having that in preparation for the preliminary determination, the dumping duties, we saw a glut of dumped Chinese mattresses that have been exported into the U.S.

And so, as they work through that, we think, probably through the first quarter, something like that, that had an effect definitely on fourth quarter results. The other thing going back to Karl's comments on the effort to get in place a dumping order, with that delay, because of the government shutdown being pushed out, we now feel like that somewhere around the end of February, product that is landed would be subject to the 90-day look back.

And, in a lot of cases, that has a cooling effect, because obviously, an imported record needs to understand their cost basis whenever they're importing products. So, we still believe that somewhere around the end of May or somewhere along in there, we'll see that preliminary determination. Hopefully, it's favorable, and we'll repatriate to the U.S. product in place of some of that dumped product.

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

A

Hey, John, I think you also asked about Flooring. Flooring, the report – external reports on carpet sales in the fourth, I'm sorry, the fourth quarter were that they were down 9% in square yards, so that led, there's obviously a high correlation between our carpet cushion sales and carpet sales, again highly correlated with the housing market in total. So, I think, it's just that general softness. We have not at all lost share. The answer to your question is, just through January, the Flooring Products business is down about 2%, but with one fewer shipping day. So, it's flattish in January.

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

Q

Thank you for that color. Good luck.

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

A

Thanks, John.

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

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you. One question on Elite, do you have a better feel at this point what the purchase accounting hit in 2019 is going to be on Elite?

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

Keith, this is Matt. We're still reviewing that, but the upshot is, in the first quarter, we will have some inventory accounting impact. It'll be a few million dollars. We don't have it specifically quantified. In a bigger picture, we currently estimate that the goodwill associated with the transaction would be something around 40% to 50% of the purchase price. I don't know if that helps some of your modeling expectations, but that's all very much being finalized, and you'll certainly see all that as we get the K filed.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

And then, you'll amortize that goodwill over kind of what period of time? Right now, there's different parts of it, and some of it drops off after like three years...

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

Yeah. That's just straightforward goodwill that will be on the balance sheet.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. And then, second question on LIFO, was negative here in the year as you discussed in the press release, did it impact the fourth quarter and what kind of expectations do you have in your guidance on – for 2019 on LIFO?

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

As – Matt – Keith, this is Matt again. As always, we start the year not assuming we have a better crystal ball than anything else – anyone else and that we assume there will be basically flat LIFO through the year, neither income nor expense, although you certainly heard Perry talk a bit about commodity trends right now and trends will move around all throughout the year. But, at the moment, we don't have any assumption of LIFO income or expense in the guidance we've provided. And that's consistent with all of our past practice historically.

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

A

And I'd just say, Keith, we expect full year LIFO will be lower than $31 million it was in 2018.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. And it played a role in the fourth quarter, positive or negative?

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

A

It well – it was. We had estimated at the end of the third quarter that it was going to be $33 million, and when we trued it up as of fourth quarter, it came in at $31 million.

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

So, it basically came in almost spot on...

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

A

Yeah.

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

...with what we thought 90 days before, and that rarely happens, of course.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay.

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

But, if you look forward to this year, we don't anticipate nearly that magnitude, LIFO expense in 2019 and for modeling purposes here, we assume, right now out of the gate that there won't be any LIFO income or expense.

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

A

And we'll estimate that each – we'll update that estimate each quarter.

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

A

Keith, the impact in the fourth quarter, LIFO was $7 million.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Fourth quarter negative. Okay. $7 million negative correct?

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

A

The expense...

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

Yeah.

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

A

...that's correct.

Keith Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

All right. Thank you.

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

A

You're welcome. Thank you.

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

Daniel Moore
Analyst, CJS Securities, Inc.

Q

Good morning. Thanks for taking the questions. As it relates to Elite, it's been only a very short while now, but wondering what you've learned, if anything, good or bad since closing the acquisition?

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

A

Yeah. Dan, it's – you are right. It will be just three weeks tomorrow, but a number of us were at the Las Vegas Furniture Market last week, and Perry and I've had a number of conversations amongst ourselves, and then with the Elite management team, and all I can tell you is, thank goodness, that we own that business. With the growth of hybrid products, the numbers of box bed mattresses that were displayed in Las Vegas, really it's very, very early, but the predictions that we made in our analysis of the strategies around Elite are proving true and that we're seeing a lot of box beds that are being sold or marketed to conventional brick-and-mortar environments that – very, very apparent in Las Vegas.

We're also seeing significant increased conversation around specialty foams and the attributes to specialty foams in terms of heat dissipation. So, we feel, again admittedly early, we're always cautious, but thank goodness, we've done that deal and what a fantastic group of managers and employees in that business. Culturally, there's such an incredible connectivity that frankly, we're blessed to have them on the team.

Daniel Moore
Analyst, CJS Securities, Inc.

Q

Got it. Just a little bit of pencil sharpening in terms of the remaining restructuring charges. Do you expect those to be frontend loaded, more evenly spread to the year, any sense there?

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

A

First half loaded for sure. There maybe a little residual into the back half, but heavily loaded to the first half.

Daniel Moore
Analyst, CJS Securities, Inc.

Q

Got it. And then, lastly, a little bit more philosophical, but, just the thought process, understanding you're very cognitive of leverage and that's appreciated, but why automatically suspend share repurchases, rather than kind of remain opportunistic given the really strong free cash flow outlook?

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

A

Dan, it almost sounds like you're trying to pick a fight between Matt and I, but, because we have that conversation, it will be very difficult based on our belief as to what the value of the equity is for us not to repurchase shares. If there is any fall off in stock price, we are extremely bullish on the company's future, and believe, well, a personal opinion, the stock is probably undervalued from a trade perspective right now. So, it's difficult, but we've made a commitment to the lenders, and to ourselves that we'll continue to deleverage. For us, to be at 3.5 times, is remarkably high and either Matt or I has history for sure, and Perry has been here longer than both of us. So, yeah, we'll continue to watch it, but any melt off it would be hard to pounce, but Matt and I will arm wrestle for that one later.

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

Yeah. Dan, we're all certainly aligned with the considerations on our deployment of cash and capital, and the very good news is, our cash flow is quite predictable. Typically, there's some seasonality to it, but it is predictable, and we have a lot of it. So, the deleveraging that we're earmarking to take place over the next 12 to 18 months is something we feel very comfortable in estimating and that it will happen promptly.

Daniel Moore
Analyst, CJS Securities, Inc.

Q

Okay. Understood. Appreciate the color again.

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

A

Dan.

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

Peter Jacob Keith
Senior Research Analyst, Piper Jaffray
Q

Hey, thanks. Good morning, everyone. So, just to follow on that last point, the operating cash flow of $550 million is a pretty big step-up from the $450 million run rate in the last two years, could you just get us comfortable on, I guess, your comfort of that acceleration, what are the key levers you plan on pulling and what are the drivers?

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.
A

Yeah. Peter, this is Matt. I'll jump in, and then, Wendy, Karl, Perry, and Mitch certainly can amplify. But, first of all, don't be surprised of course that it reflects the ECS acquisition and we have been very clearly stating that the sales expectation that will arrive from ECS this year is estimated to be $675 million. You'll also recall reading that we anticipate fully that the EBITDA margin on that sales base will be higher than the company average. So, you could do math there to see that EBITDA will be driving significantly higher from this 2018 level of $573 million that we just posted company-wide for Leggett before we owned ECS.

Secondly, as you saw in the fourth quarter, once again, our working capital performance strongly ended the year and I know, both Mitch and Perry and certainly Karl are working hard to be able not ride in that 12% range of working capital investment, which we did most of 2018. We were working hard to make sure that the improved performance of a pretty significant nature this year is sustained throughout 2019, that won't actually flush up a meaningful amount of cash.

And otherwise, when you think about going further to the cash flow statement, the capital spending is pretty predictable. We talked about M&A dialing down significantly, share repurchases, same as Karl just mentioned. So, that circa $550 million of operating cash flow is readily correlated to the higher earnings, ECS being part of the family, working capital concentration and focus, and really no surprise, uses of cash on the operating side. And, again, we feel very confident about that expectation you should use in your model.

Peter Jacob Keith
Senior Research Analyst, Piper Jaffray
Q

Okay. Thanks, Matt. I had one bigger picture follow-up, and I guess, I'll just refer back to the TSR target, where you're looking for, historically around 7% to 10% EPS growth. And this year, at the midpoint, I guess, you're guiding for 3%. So, there are sort of a lot of puts and takes in the business right now, but I was hoping, you could maybe just provide a high level sweep on what are the main challenges to not being in line with your TSR for 2019?

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

Peter, this is Wendy. I'll take a stab at this. If you think about EPS, it's going to be a big generator in a short-term, and really over the, at least the first three-year period for the sales growth. We expect margins to be consistent. Of course, share repurchases are going to be lower. But, as Matt said, with the strong operating performance of ECS, added to expected margin improvement in our other businesses, we think, we're going to be able to achieve that 11% to 14% TSR. So, think about it as long-term, we're not changing our TSR target, and we're not changing the individual components of TSR. In the short-term, while we, for instance, suspend share repurchases, they'll change a little bit. So, we think, we positioned the company well to achieve that 11% to 14%.

Peter Jacob Keith
Senior Research Analyst, Piper Jaffray

Q

Okay. Maybe just a follow-up. I guess, I was even – I was thinking about the earnings growth ex-buyback is at 7% to 10%. So, the top line growth is a little like margins, they're kind of flat to down. If someone would say why is Leggett not guiding in line, could just give us, again, any broad brushstrokes on what the key challenges are for this year, even if those are going to go away looking at the 2020?

A

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

A

Yeah, the key challenges, well, we have the – from an ECS perspective, we're dealing with the purchase accounting issue, which will be mitigated to some degree in time. So, that's one issue. One of the challenges with doing an acquisition of that size, you kind of pay for it from an accounting perspective in year one; to a lesser degree, in year two.

There certainly is uncertainty in the macro environment. It's difficult to guide in this environment. The other good – earlier good question about tariffs, we don't know; government shutdown, we don't know; Brexit impact, we don't know. So, we are coming up with the best guidance that we feel comfortable putting out there, and, as Wendy said, those TSR guiding – targets are longer term, and we feel very comfortable as we sit here today that we'll be in that range.

Peter Jacob Keith
Senior Research Analyst, Piper Jaffray

Q

Okay. I appreciate all the color, Karl. Thanks a lot.

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

A

Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Justin Bergner with Gabelli & Company. Please proceed with your question.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC

Q

Good morning, everyone.

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

A

Good morning.

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

Hi, Justin.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC

Q

I guess, just to start with ECS, should I think of the increase in depreciation amortization from sort of the $140 million run rate at the end of the year to $210 million, that step-up is almost all ECS?

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

A

Virtually all.

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

Yes. So, we've had some higher capital spending as you know in the last two years, but yes, the vast majority of that is associated with ECS.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC

Q

Okay. And so, you're not adding back any ECS costs outside of transaction costs in your adjusted EPS framework, correct?

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

We are not adding back any additional costs...understand your question, so...

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC

Q

The only costs you're adding back for ECS are transaction costs?

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

Well, we've got the – as an inventory write-up phenomenon, it's an accounting GAAP treatment that will happen in the first quarter that we've done, but beyond that, there is no significant add back and cost associated with ECS.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC

Q

But, the inventory cost will not be added back for your adjusted EPS framework, you'll eat that cost in cost in the first quarter...

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc.

A

Yes.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC

Q

for your adjusted? Okay.

Matthew C. Flanigan
Chief Financial Officer, Executive Vice President & Director, Leggett & Platt, Inc. A

Yes.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC Q

Should I think of the 10% sales growth for ECS in 2019 maybe a little bit less than 10% sales, because it's compared to a $611 million for the 12 months through September. I mean, it seemed like when you announced that deal, you might have had expectations for, sort of, sales growth more in the double-digit range, has that tapered down or the end-markets caused you to taper down?

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

It's not – Justin, this is Karl. It's not end-markets, its deflation. So, there's about 5% of the early expected growth in ECS that is being pulled back. Said differently, the chemical input costs have decreased significantly. So, the resultant sales dollars will be lower than originally expected. But, the EBITDA margins will not be negatively impacted by that. So, your observation is correct, the forecast is about a 10% growth. If raw material input costs would have stayed neutral, we would have been looking at about a 15% growth rate.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC Q

Okay. So, when you said EBITDA margins will stay similar or do you mean EBITDA dollars will stay similar?

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

Yeah, I should've said dollars.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC Q

Okay. That's what I thought. And then, just two other non-ECS-related questions. You mentioned that in the earnings framework for 2019, you'll have some benefit from the timing related to steel pricing offsetting tax, keeping your margin profile, I guess, pretty constant or at least organically, and I guess, I'm wondering why aren't you seeing any operating leverage besides deal timing related from the zero to 3% organic sales growth given that you should be seeing some benefit in your Fashion Bed and Home Furniture from the actions you're taking?

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

Justin, we do expect to see some margin improvement from our – in the core Leggett business. Remember, ECS is going to be slightly dilutive to EBIT margins, and in addition to higher tax rate, we've got higher interest expense, and we're going to have a higher share count. So, we have a few small headwinds if you will, but we do expect to see margin improvement in the core Leggett business.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC Q

Okay. That's helpful. And then, lastly, any comment on Quantum Edge growth in the quarter? I think you spoke about it last quarter.

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

A

Justin, this is Perry. Yeah, Quantum Edge and the overall category of ComfortCore continues to grow. For the full year last year, our ComfortCore, as a percent of our innersprings, is about 46%. It was a little stronger than that in the fourth quarter. And, of those ComfortCore innersprings, in the fourth quarter, about 37% were Quantum Edge.

That continues to grow. In fact, we saw a great representation of, what we call, ActivEdge, which encompasses Quantum Edge, it's all of those coil-encased products as opposed to foam-encased products. We saw a great representation of new introductions and existing product lines that recently completed Las Vegas markets. So, we believe that content gain story that we've been preaching for some time now will continue throughout 2019.

Justin Bergner
Co-Portfolio Manager, Gabelli Funds LLC

Q

Thank you for taking all my questions.

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

A

Thank you.

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

A

Thanks, Justin.

Operator: Thank you. There are no further questions at this time. I would like to turn the call back over to Ms. Watson for any closing remarks.

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

Thank you, everybody for participating today, and we'll 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 and have a wonderful day.