NEW RISK ALERT: (SWK)

Stanley Black & Decker Gets Free Pass on Debt Covenants, Disingenuously Blames Pandemic

Investors should hold the tool company accountable for kitchen sink EBITDA add-backs even if lenders won't.

By Nick Winkler
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This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Stanley's New EBITDA Add-Backs Aren't Primarily COVID-19 Related As the Company Says

Like many, Stanley Black & Decker, best known for its tool and storage business, strips out non-cash charges like interest expense and stock based compensation from its EBITDA calculation. This calculation is important as it is used to determine whether the company is in compliance with a key debt covenant. In its 2020 10-K, Stanley Black & Decker emphasized the importance of the covenant:

> *"The Company has an interest coverage covenant that must be maintained to permit continued access to its committed credit facilities…"*

To ensure it doesn't breach the covenant, Stanley Black & Decker— with the blessing of its lender, Citibank— disclosed it will strip out additional items from its EBITDA calculation, presumably to make it more likely the company remains in compliance with the covenant:

> *"In April 2020, the Company entered into an amendment to: (a) amend the definition of Adjusted EBITDA to allow for **additional adjustment addbacks, which primarily relate to anticipated incremental charges related to the COVID-19 pandemic**, for amounts incurred beginning in the second quarter of 2020 through the second quarter of 2021…"*

Leading investors to believe the new add backs are primarily related to COVID-19 expenses is disingenuous. Though Stanley Black & Decker's annual report is light on details, the amended

credit agreement reveals the company has wide discretion when determining what it can now add back to EBITDA, including:

- Restructuring charges
- Charges for facility closures
- Acquisition and integration charges related to mergers and acquisitions, including those associated with the Consolidated Aerospace Manufacturing, LLC transaction
- Voluntary retirement program charges
- Supplemental unemployment plan charges
- Business transformation charges
- Margin resiliency program charges

The only limit, it seems, is that Stanley's add-backs can't exceed $500 million. In 2020, Stanley's results included $400 million in pre-tax charges related to many of the new items the company is now allowed to add back. In 2019, Stanley's results included $363 million in pre-tax charges, many of which will no longer count against EBITDA.

If that's not enough, the amended agreement also substantially reduces Stanley's interest coverage ratio from 3.5 to 2.5 times.

Stanley Black & Decker is a serial acquirer. It's constantly integrating deal costs, restructuring, and transforming. Blaming the pandemic for these recurring charges tells investors more about management than it does the company's operating earnings.