

## Illinois Tool Works (ITW)

**\$174.85** (As of 06/30/20)

Price Target (6-12 Months): **\$184.00**

Long Term: 6-12 Months

**Zacks Recommendation:**
**Neutral**

(Since: 09/24/18)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**4-Sell**

Zacks Style Scores:

VGM:C

Value: D

Growth: B

Momentum: F

## Summary

Illinois Tool is poised to gain from a diversified business structure, enterprise initiatives and the policy of rewarding shareholders handsomely. Notably, the enterprise initiative contributed 120 basis points to the operating margin in the first quarter of 2020. Its cost-reduction actions will likely help in offsetting some of the pandemic-induced financial burdens. However, for 2020, it withdrew its previously issued projections due to the pandemic. For the second quarter, it expects a sales decline of 30-40% year over year, with Automotive OEM declining 60-70%. Operating income is expected to be \$200-\$400 million and free cash flow to exceed \$500 million in the second quarter. Forex woes and high debts might be dragging, though healthy liquidity is a relief. In the past three months, the company's shares have underperformed the industry.

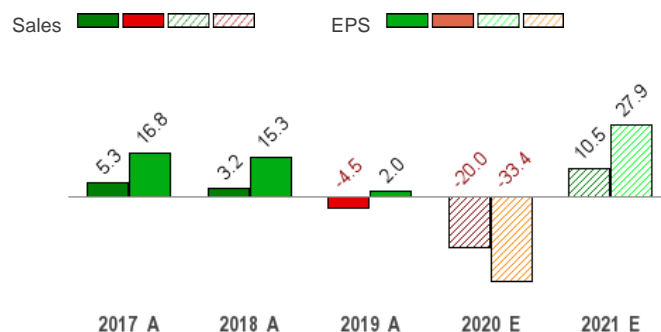
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	\$190.85 - \$115.94
20 Day Average Volume (sh)	1,564,392
Market Cap	\$55.2 B
YTD Price Change	-2.7%
Beta	1.16
Dividend / Div Yld	\$4.28 / 2.4%
Industry	<a href="#">Manufacturing - General Industrial</a>
Zacks Industry Rank	Bottom 30% (177 out of 253)

## Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.5%
Last Sales Surprise	-3.2%
EPS F1 Est- 4 week change	-1.5%
Expected Report Date	07/24/2020
Earnings ESP	-13.0%
P/E TTM	22.7
P/E F1	33.9
PEG F1	4.5
P/S TTM	4.0

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	3,225 E	2,774 E	3,000 E	3,330 E	12,471 E
2020	3,228 A	2,332 E	2,688 E	3,050 E	11,281 E
2019	3,552 A	3,609 A	3,479 A	3,469 A	14,109 A

## EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.76 E	\$1.35 E	\$1.60 E	\$1.90 E	\$6.60 E
2020	\$1.77 A	\$0.67 E	\$1.17 E	\$1.53 E	\$5.16 E
2019	\$1.81 A	\$2.00 A	\$2.04 A	\$1.88 A	\$7.75 A

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/30/2020. The reports text is as of 07/01/2020.

## Overview

Headquartered in Glenview, IL, Illinois Tool Works Inc. is a worldwide manufacturer of highly engineered products and specialty systems. The company's diversified range of industrial products and equipment are sold in 53 countries (data as of 2019-end). The company operates through seven operating business segments. A brief discussion is given below:

**Test & Measurement and Electronics** (15% of 2019 total segmental revenues): This segment deals with the production of equipment, consumables and related software for testing and measuring materials and structures, and equipment and consumables used in the production of electronic subassemblies and microelectronics. Products are mainly used in automotive original equipment manufacturers and tiers, general industrial, consumer durables and other markets.

**Automotive OEM** (21.7%): This segment produces fasteners and components for automotive-related applications. Products are mainly used by original equipment manufacturers in the automotive industry.

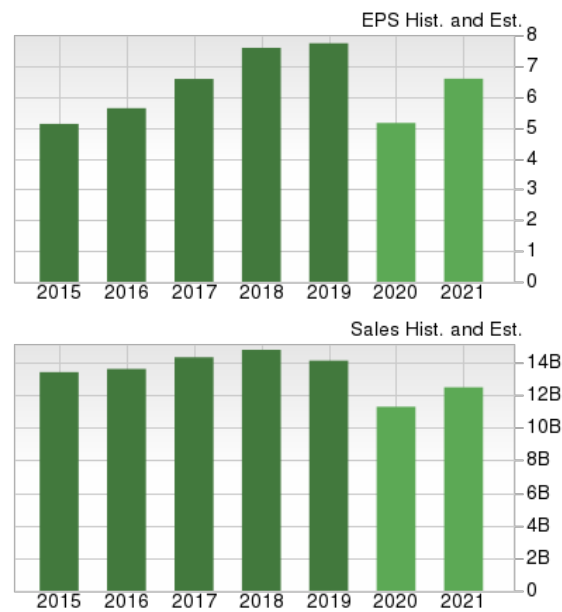
**Polymers & Fluids** (11.8%): This segment produces lubrication and cutting fluids, sealants, janitorial and hygiene products, adhesives, and fluids and polymers. It serves customers in general industrial, automotive aftermarket and other markets.

**Food Equipment** (15.5%): This segment is responsible for production and offering of commercial food equipment and related services. Customers mainly belong to restaurant, food retail and food service markets.

**Welding** (11.6%): This segment manufactures arc welding equipment, consumables and accessories. Products are mainly used in general industrial, fabrication, energy, construction, industrial capital goods, and other markets.

**Construction Products** (11.5%): This segment produces construction-fastening systems and truss products for commercial construction, residential construction and renovation markets.

**Specialty Products** (12.9%): This segment produces product coding and marking equipment and consumables, beverage packaging equipment and consumables, and appliance components and fasteners.



---

## Reasons To Buy:

- ▲ In the quarters ahead, Illinois Tool anticipates benefiting from its diversified businesses, solid product offerings and healthy liquidity position (including revolving credit facility, \$1.4 billion in cash and cash equivalents, and minimal short-term debt). Also, its enterprise strategy—including Business Structure Simplification, Portfolio Management and Strategic Sourcing — might be beneficial. Notably, the enterprise initiative contributed 120 bps to the operating margin in the first quarter of 2020.
  - ▲ Illinois Tool has undertaken measures for the safety of its workers, management of supply chain and providing continued services to customers. It is using 95% of its manufacturing capabilities across the globe. Also, cost-reduction actions are being considered to mitigate some of the financial stress caused by the pandemic. For the second quarter, the company expects operating income of \$200-\$400 million and free cash flow of more than \$500 million.
  - ▲ Illinois Tool remains committed to rewarding its shareholders substantially through dividend payments and share buybacks. In the first quarter of 2020, the company paid out dividends of \$1.07 per share to its shareholders while its diluted shares outstanding decreased by 9.9 million over the year-ago quarter. Notably, the quarterly dividend rate was hiked 7% in August 2019. The company noted that dividend payments remain a priority, while share buybacks have been halted temporarily due to the pandemic.
- 

Enterprise policies, rewards to shareholders and a diversified business portfolio will likely work in Illinois Tool's favor, going forward. Also, cost-reduction actions will help in mitigating some pandemic-induced financial burden.

---

## Reasons To Sell:

- ▼ In the past three months, Illinois Tool's shares have gained 23.5% compared with the industry's growth of 24%. Also, on a P/E (TTM) basis, the company's shares currently seem to be overvalued compared with the industry, with respective tallies of 22.74x and 20.14x. Also, the industry's current multiple is higher than the industry's three-month highest level of 20.28x. In first-quarter 2020, the company's earnings declined 2.2% from the year-ago quarter on weak sales generation. Organic sales in the quarter decreased 6.6% year over year. Due to uncertainties related to the pandemic, the company has suspended its previously issued 2020 projections. For the second quarter, it expects a sales decline of 30-40%, with Automotive OEM declining 60-70% year over year. In the past 60 days, the company's earnings estimates have been lowered by 14.9% for 2020 and 7.6% for 2021.
- ▼ The company generates a substantial portion of revenues from international operations. Although international businesses provide geographical diversity, these expose it to unfavorable movements in foreign currencies and geopolitical issues. Also, higher contribution from international operations is detrimental to operating margin expansion as foreign sales usually carry lower margins compared with domestic sales. In first-quarter 2020, impact of negative foreign exchange lowered sales by 1.5%. Also, organic sales in Europe declined 7%, while that in China dipped 24% year over year. North America's organic sales were down 5%.
- ▼ A highly leveraged balance sheet can inflate Illinois Tool's financial obligations and subsequently hurt profitability. In five years (2015-2019), the company's long-term debt increased 2.4% (CAGR). Long-term debt balance at the end of the first quarter of 2020 was \$7,690 million. Further, it seems to be more leveraged than the industry. The stock's long-term debt-to-capital is 77.1%, higher than the industry's 50.2%.

The coronavirus impact will likely adversely influence Illinois Tool's second-quarter revenues, with sharp a decline expected for Automotive OEM. Also, forex woes and high debts might be concerning.

## Last Earnings Report

### Illinois Tool Q1 Earnings Beat Estimates, View Weak

Illinois Tool delivered better-than-expected results for first-quarter 2020, with an earnings surprise of 3.5%. This was the seventh consecutive quarter of impressive results.

The industrial tool maker's earnings in the reported quarter were \$1.77 per share, surpassing the Zacks Consensus Estimate of \$1.71. Also, the bottom line decreased 2.2% from the year-ago reported number of \$1.81.

Quarter Ending **03/2020**

Report Date	May 05, 2020
Sales Surprise	-3.19%
EPS Surprise	3.51%
Quarterly EPS	1.77
Annual EPS (TTM)	7.69

### Revenue Details

Illinois Tool generated revenues of \$3,228 million in the reported quarter, reflecting a decline of 9.1% from the year-ago figure. Top-line results were affected by a 1.5% impact of unfavorable foreign currency movement, 1% from divestitures/acquisitions, and a 6.6% drop in organic sales.

Also, the top line lagged the Zacks Consensus Estimate of \$3,334 million by 3.2%.

Illinois Tool reports revenues under the segments discussed below:

**Test & Measurement and Electronics'** revenues in the first quarter decreased 7.5% year over year to \$485 million. Revenues from **Automotive OEM** (Original Equipment Manufacturer) declined 13.7% to \$696 million. **Food Equipment** generated revenues of \$483 million, decreasing 6.8% year over year.

**Welding** revenues were \$372 million, declining 12.8% year over year. **Construction Products'** revenues were down 2.6% to \$390 million. Further, revenues of \$414 million from **Specialty Products** reflected a decline of 10.9%. **Polymers & Fluids'** revenues of \$393 million declined 5.5% year over year.

### Margin Profile

In the reported quarter, Illinois Tool's cost of sales declined 9.1% year over year to \$1,871 million. Selling, administrative, and research and development expenses declined 8.3% year over year to \$560 million. It represented 17.4% of the first quarter's revenues.

Operating margin was flat at 23.6%. Enterprise initiatives contributed 120 bps to operating margin, while price/costs and others had positive impacts of 20 bps and 10 bps, respectively. However, volume leverage had a negative impact of 150 bps. Interest expenses in the quarter declined 19% year over year to \$51 million.

### Balance Sheet and Cash Flow

Exiting the first quarter, Illinois Tool had cash and cash equivalents of \$1,430 million, down 27.8% from \$1,981 million recorded at the end of the last reported quarter. Long-term debt decreased 0.8% sequentially to \$7,690 million.

In the first quarter, the company generated net cash of \$614 million from operating activities, reflecting a decline of 0.3% from the year-ago quarter. Capital spending on the purchase of plant and equipment was \$60 million, down 22.1% year over year. Free cash flow was \$554 million, reflecting a year-over-year increase of 2.8%.

In the first quarter, the company's dividend payments amounted to \$1.07 per share.

### Outlook

In the quarters ahead, Illinois Tool anticipates benefiting from its diversified businesses, solid product offerings and healthy liquidity position (including revolving credit facility, \$1.4 billion in cash and cash equivalents, and minimal short-term debt).

Due to uncertainties related to the pandemic, the company has suspended its previously issued 2020 projections. Dividend payments remain a priority, while share buybacks have been halted temporarily.

For the second quarter, the company expects a sales decline of 30-40%, with Automotive OEM declining 60-70% year over year. Operating income will likely be \$200-\$400 million, while free cash flow will probably exceed \$500 million.

## Recent News

### Dividend

On **May 8, 2020**, Illinois Tool's board of directors declared a quarterly dividend of \$1.07 per share to shareholders of record as of Jun 30, 2020. Notably, the dividend will be paid out on Jul 15, 2020.

### Valuation

Illinois Tool's shares declined 2.6% in the year-to-date period, while increased 16.8% in the trailing 12-month period. Stocks in the Zacks sub-industry are down 16.4%, while the Zacks Industrial Products sector decreased 13.4% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector decreased 10.6% and 6.4%, respectively.

The S&P 500 Index has moved down 5.2% year to date and increased 3.3% in the past year.

The stock is currently trading at 29.75x forward 12-month earnings per share, which compares to 25.97x for the Zacks sub-industry, 21.25x for the Zacks sector and 21.87x for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.35x and as low as 14.63x, with a 5-year median of 19.17x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$184 price target reflects 31.24x forward 12-month earnings per share.

The table below shows summary valuation data for ITW.

Valuation Multiples - ITW					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	29.75	25.97	21.25	21.87
	5-Year High	31.35	26.53	21.5	22.14
	5-Year Low	14.63	15.6	12.55	15.25
	5-Year Median	19.17	19.58	16.74	17.52
EV/EBITDA F12M	Current	19.63	17.13	18.79	13.21
	5-Year High	21.42	18.88	20.66	14.2
	5-Year Low	9.71	8.2	10.6	9.01
	5-Year Median	13.13	11.15	14.22	10.97
EV/Sales F12M	Current	4.99	3.56	3.11	3.17
	5-Year High	5.43	3.93	3.4	3.52
	5-Year Low	2.51	1.81	1.76	2.28
	5-Year Median	3.6	2.6	2.32	2.83

As of 06/30/2020

## Industry Analysis Zacks Industry Rank: Bottom 30% (177 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
Dover Corporation (DOV)	Neutral	3
GEA GROUP AG SP (GEAGY)	Neutral	3
IHI CORP (IHICY)	Neutral	3
ParkerHannifin Corporation (PH)	Neutral	3
Roper Technologies, Inc. (ROP)	Neutral	3
SUMITOMO HEAVY (SOHVY)	Neutral	3
Tetra Tech, Inc. (TTEK)	Neutral	3
Atlas Copco AB (ATLKY)	Underperform	3

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	ITW	X Industry	S&P 500	IHICY	PH	ROP
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	3	3	3
VGM Score	C	-	-	A	A	B
Market Cap	55.24 B	1.15 B	21.75 B	2.34 B	23.50 B	40.53 B
# of Analysts	10	3	14	2	10	6
Dividend Yield	2.45%	0.00%	1.93%	0.89%	1.92%	0.53%
Value Score	D	-	-	A	A	D
Cash/Price	0.03	0.10	0.07	0.58	0.04	0.02
EV/EBITDA	15.63	11.80	12.71	3.14	12.03	15.58
PEG Ratio	4.43	3.35	2.86	NA	1.60	3.04
Price/Book (P/B)	24.19	1.60	2.97	0.72	3.73	4.23
Price/Cash Flow (P/CF)	19.05	10.19	11.71	3.56	11.77	22.50
P/E (F1)	33.56	26.98	21.23	379.00	18.86	31.93
Price/Sales (P/S)	4.01	1.15	2.30	0.18	1.65	7.46
Earnings Yield	2.95%	3.34%	4.48%	0.26%	5.30%	3.13%
Debt/Equity	3.37	0.52	0.76	0.65	1.28	0.49
Cash Flow (\$/share)	9.18	2.49	7.01	1.06	15.57	17.25
Growth Score	B	-	-	B	B	B
Hist. EPS Growth (3-5 yrs)	11.57%	11.57%	10.93%	-32.02%	17.20%	20.17%
Proj. EPS Growth (F1/F0)	-33.42%	-32.20%	-9.77%	-88.89%	0.00%	-6.84%
Curr. Cash Flow Growth	-2.44%	4.08%	5.51%	-25.60%	6.37%	11.79%
Hist. Cash Flow Growth (3-5 yrs)	4.24%	5.59%	8.62%	NA	7.55%	16.15%
Current Ratio	2.71	2.19	1.30	1.18	1.49	0.96
Debt/Capital	77.10%	34.34%	44.41%	39.54%	56.22%	32.77%
Net Margin	18.06%	4.33%	10.62%	0.92%	9.32%	30.17%
Return on Equity	87.33%	10.81%	15.75%	1.75%	24.30%	14.94%
Sales/Assets	0.93	0.78	0.55	0.82	0.72	0.31
Proj. Sales Growth (F1/F0)	-20.04%	-8.24%	-2.43%	-13.70%	0.00%	0.76%
Momentum Score	F	-	-	F	B	A
Daily Price Chg	2.61%	0.24%	1.41%	0.00%	2.06%	0.68%
1 Week Price Chg	-1.79%	-2.15%	-3.90%	0.00%	-5.68%	-0.86%
4 Week Price Chg	1.49%	0.92%	-1.62%	26.33%	-1.02%	-1.86%
12 Week Price Chg	14.83%	13.74%	15.67%	-39.84%	38.46%	26.01%
52 Week Price Chg	16.77%	-15.39%	-8.07%	-36.28%	9.38%	3.95%
20 Day Average Volume	1,564,392	97,187	2,699,706	68	1,368,507	594,218
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-1.53%	0.00%	0.00%	-88.24%	0.00%	0.19%
(F1) EPS Est 12 week change	-23.61%	-29.76%	-10.28%	-92.86%	3.61%	-5.17%
(Q1) EPS Est Mthly Chg	-0.74%	0.00%	0.00%	NA	0.00%	0.00%

---

## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

---

### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	<b>D</b>
Growth Score	<b>B</b>
Momentum Score	<b>F</b>
VGM Score	<b>C</b>

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

---

### Disclosures

**This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page.** Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.