

Illinois Tool Works (ITW)

\$185.76 (As of 02/05/20)

Price Target (6-12 Months): **\$195.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 09/27/18)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: D

Growth: B

Momentum: F

Summary

Illinois Tool is poised to gain from a diversified business structure, enterprise initiatives and shareholder friendly policies. For 2020, the company expects operating margin to gain from a 100-bps contribution from enterprise endeavors. Also, it remains committed to rewarding shareholders substantially through dividend payments and share buybacks. For 2020, share buybacks are likely to total \$2 billion. Total revenues are anticipated to be \$13.8-14.1 billion, suggesting a dip of 2% to no change year over year. Divestitures and Product Line Simplification initiatives will adversely impact sales by 1% and 0.5%, respectively. Forex woes might hurt sales by 1%. Also, the company faces risks from high debts. In the past three months, the stock has underperformed the industry. Further, analysts have become increasingly bearish on the company.

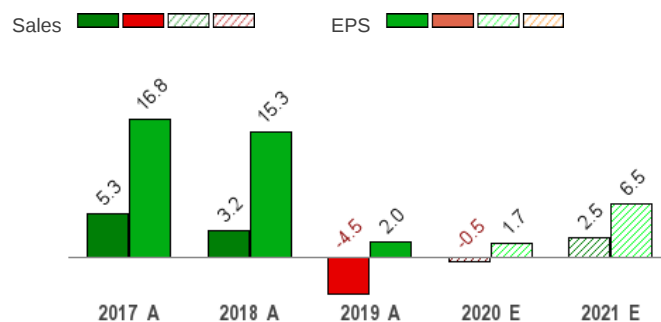
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$185.76 - \$133.16
20 Day Average Volume (sh)	1,329,166
Market Cap	\$59.7 B
YTD Price Change	3.4%
Beta	1.23
Dividend / Div Yld	\$4.28 / 2.3%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 16% (214 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.6%
Last Sales Surprise	0.6%
EPS F1 Est- 4 week change	-0.4%
Expected Report Date	04/23/2020
Earnings ESP	0.0%
P/E TTM	24.0
P/E F1	23.6
PEG F1	3.1
P/S TTM	4.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	3,563 E	3,669 E	3,589 E	3,569 E	14,393 E
2020	3,480 E	3,575 E	3,493 E	3,488 E	14,036 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	\$1.98 E	\$2.15 E	\$2.17 E	\$2.08 E	\$8.39 E
2020	\$1.87 E	\$2.01 E	\$2.02 E	\$1.96 E	\$7.88 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 02/05/2020. The reports text is as of 02/06/2020.

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 55 countries. 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.

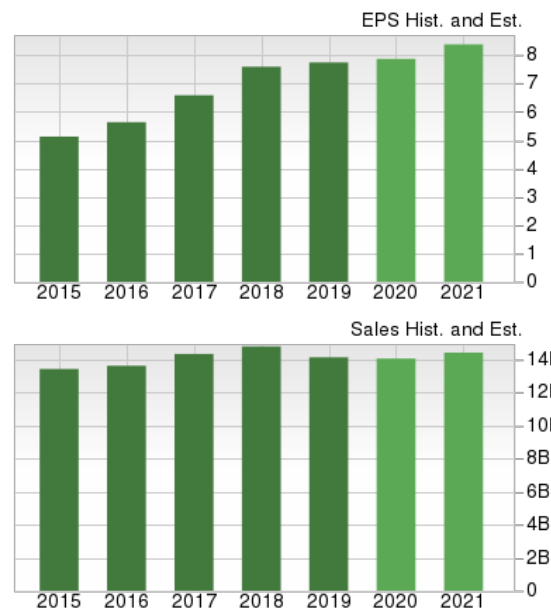
Polymers & Fluids (11.8%): This segment produces lubrication and cutting fluids, sealants, janitorial and hygiene products, adhesives, and fluids and polymers. It serves customers in general industrial, automotive aftermarket and other markets.

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. Markets served include con



Reasons To Buy:

▲ In the fourth quarter of 2019, Illinois Tool's earnings surpassed estimates by 1.62%. On a year-over-year basis, the bottom line also improved 2.7% from the year-ago figure, mainly owing to margin improvement and a 2.6% fall in share count. Notably, enterprise initiatives contributed 130 bps to the operating margin in the fourth quarter. Notably, the company introduced the Enterprise Strategy including Business Structure Simplification, Portfolio Management and Strategic Sourcing in 2012. Business Structure Simplification and Portfolio Management strategies strengthened the company's organic sales while Strategic Sourcing helped manage costs and improved margins. For 2020, Illinois Tool anticipates continued benefits from these measures, aiding the operating margin by 100 bps. The company predicts operating margin of 24.5-25%.

Benefits of enterprise policies, rewards to shareholders in forms of dividends and share buybacks, and a diversified business portfolio will likely work in Illinois Tool's favor, going forward.

▲ Illinois Tool remains committed to rewarding its shareholders substantially through dividend payments and share buybacks. In the fourth quarter, it repurchased shares worth \$375 million and paid out dividends of \$1.07 per share to its stockholders. For 2019, the company returned funds worth \$2.8 billion to its shareholders including share buybacks of \$1.5 billion. Quarterly dividend rate was hiked 7% in August 2019. For 2020, the company anticipates buying back roughly \$2 billion shares including \$500 million of repurchase for offsetting the dilutive impact of divestitures completed in 2019.

▲ Illinois Tool operates 87 business divisions under seven reportable segments. Of the total, the company believes that seven divisions are long-term growth challenged and hence, it is intending to divest those. It believes that the potential divestitures of these divisions, as and when completed, will boost organic sales growth by 50 bps and add 100 bps to operating margin. Impact on earnings is predicted to be neutral. In 2020, the company plans to sell off businesses with revenues totalling \$1 billion. In addition, the company set long-term targets, which reflect strength of its unique business model, non-imitable diversified business portfolio and highly skilled management team. Between 2019 and 2023, the company anticipates achieving organic revenue growth of 3-5%. Operating margin is predicted to be roughly 28% and earnings per share are likely to rise 7-10%. Further, after-tax return on invested capital is projected to be approximately 40%. Free cash flow will likely be more than 100% of net income. Dividend payout ratio is expected to be roughly 50%.

Reasons To Sell:

- ▼ In the past three months, Illinois Tool's shares have gained 5.2% versus the industry's growth of 5.9%. In the fourth quarter, the company's revenues declined 3.1% year over year. Organically, sales slipped 1.6% year over year due to soft demand in the period. Notably, the company's organic performance in the Automotive OEM segment was adversely impacted by a strike at General Motors. In addition, organic performance was weak in Welding, Polymers & Fluids, Construction Products and Specialty Products segments. Also, PLS initiatives left a 0.6% negative impact on the quarter's organic sales. For 2020, the company expects total revenues to be \$13.8-14.1 billion, suggesting a decline of 2% to flat from \$14.1 billion reported in 2019. Divestitures and PLS initiatives will leave an adverse impact of 1% and 0.5%, respectively. In addition, analysts have become increasingly bearish on the company over the past seven days. Consequently, the Zacks Consensus Estimate for 2020 earnings has trended down from \$7.91 to \$7.87.
- ▼ The company generates a substantial portion of revenues from international operations. Although international businesses provide geographical diversity, the same exposes the company to unfavorable movements in foreign currencies and geopolitical issues. Also, higher contribution from international operations is detrimental to the operating margin expansion as foreign sales usually carry lower margins compared with the domestic sales. In fourth-quarter 2019, the impact of negative foreign exchange dented sales by 1%. Also, overseas business in the quarter was down 1% year over year while North America operations declined 2%. For 2020, forex woes are predicted to adversely impact revenue growth by 1% and earnings by 10 cents per share.
- ▼ 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 fourth quarter was \$7,754 million, reflecting a deterioration of 28.6% from the 2018 level. Also, the company seems to be more leveraged than the industry. The stock's long-term debt-to-capital ratio is 71.9%, higher than the industry's 47.3%.

Weak revenues, forex woes and high debts might dampen Illinois Tool's profitability in the upcoming quarters.

Last Earnings Report

Illinois Tool Q4 Earnings and Sales Beat Estimates

Illinois Tool delivered better-than-expected results for fourth-quarter 2019 with a positive earnings surprise of 1.62%.

The industrial tool maker's adjusted earnings in the reported quarter were \$1.88 per share, surpassing the Zacks Consensus Estimate of \$1.85. The results excluded 11-cents gain from divestitures.

Also, the bottom line increased 2.7% year over year, driven by margin improvement and a 2.6% fall in share count. However, forex woes and higher restructuring charges had an adverse impact of 6 cents.

For 2019, the company's adjusted earnings (excluding divestitures gains of 9 cents) were \$7.65 per share, increasing 0.7% from the year-ago figure. Also, the results surpassed the Zacks Consensus Estimate of \$7.61.

Segmental Revenues

Illinois Tool generated revenues of \$3,469 million in the reported quarter, reflecting a decline of 3.1% from the year-ago figure. Top-line results were affected by a 1% impact of unfavorable foreign currency movement, 0.5% from divestitures, and a 1.6% drop in organic sales.

Notably, PLS initiatives had an adverse 0.6% impact on organic sales, and General Motors Company strike had a negative impact of 0.5%.

However, the top line surpassed the Zacks Consensus Estimate of \$3,447 million by 0.6%.

Illinois Tool reports revenues under the segments discussed below:

Test & Measurement and Electronics' revenues in the fourth quarter increased 2.6% year over year to \$552 million. Revenues from **Automotive OEM** declined 6.7% to \$725 million. **Food Equipment** generated revenues of \$571 million, increasing 0.7% year over year.

Welding revenues were \$387 million, declining 6.5% year over year. **Construction Products'** revenues were down 3.3% to \$384 million. Further, revenues of \$446 million from **Specialty Products** reflect a decline of 4.6%. **Polymers & Fluids'** revenues of \$408 million declined 3.3% year over year.

For 2019, the company's revenues were \$14.1 billion, reflecting a 4.5% decline from the previous year.

Margin Profile

In the reported quarter, Illinois Tool's cost of sales declined 3.5% year over year to \$2,022 million. It represented 58.3% of the quarter's revenues versus 58.6% in the year-ago quarter. Selling, administrative, and research and development expenses grew 1.4% year over year to \$586 million. It represented 16.9% of the fourth quarter's revenues.

Excluding restructuring charges, operating margin was 24.1%, up 10 basis points (bps) year over year. Enterprise initiatives contributed 130 bps to operating margin and price/costs had a positive impact of 30 bps. Interest expenses in the quarter declined 19% year over year to \$51 million.

Balance Sheet and Cash Flow

Exiting the fourth quarter, Illinois Tool had cash and cash equivalents of \$1,981 million, up 8.5% from \$1,825 million recorded at the end of the last reported quarter. Long-term debt increased 1.5% sequentially to \$7,754 million.

In the fourth quarter, the company generated net cash of \$774 million from operating activities, reflecting a decline of 4.3% from the year-ago quarter. Capital spending on the purchase of plant and equipment was \$82 million, same as the previous-year quarter. Free cash flow was \$692 million, reflecting a year-over-year decrease of 4.8%.

In the fourth quarter of 2019, the company bought back \$375 million worth of common shares. Moreover, its rewards to shareholders amounted to \$2.8 billion in 2019, including share buybacks of \$1.5 billion.

Outlook

For 2020, Illinois Tool projects GAAP earnings of \$7.65-\$8.05 per share.

The company anticipates organic revenues to be flat to up 2% in the year. Forex woes will likely have a 1% adverse impact on revenue growth and divestitures will have similar impacts too. PLS initiatives will likely have an adverse impact of 0.5%.

Total revenues will likely be \$13.8-14.1 billion, suggesting a decline of 2% to flat from \$14.1 billion reported in 2019.

The company expects operating margin of 24.5-25%. The results will likely gain from roughly 100 bps of contributions from enterprise initiatives. Effective tax rate will likely be 23.5-24.5%.

Free cash flow will likely be more than 100% of net income. The company is likely to buy back shares worth \$2 billion in the year.

Quarter Ending 12/2019

Report Date	Jan 31, 2020
Sales Surprise	0.63%
EPS Surprise	1.62%
Quarterly EPS	1.88
Annual EPS (TTM)	7.73

Recent News

Dividend

On **Jan 15, 2020**, Illinois Tool paid a quarterly cash dividend of \$1.07 per share to shareholders of record as of Dec 31.

Valuation

Illinois Tool's shares are up 3.4% and 37.6% in the year-to-date and the trailing 12-month periods, respectively. Stocks in the Zacks sub-industry are up 3%, while the Zacks Industrial Products sector is down 1.3% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 26.7% and 10.5%, respectively.

The S&P 500 index has moved up 2.3% year to date and 20.9% in the past year.

The stock is currently trading at 23.42x forward 12-month earnings per share, which compares to 21.58x for the Zacks sub-industry, 18.05x for the Zacks sector and 18.88x for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.91x and as low as 14.63x, with a 5-year median of 18.62x. Our Neutral recommendation is indicative of the stock's in-line performance with the market. Our \$195 price target reflects 24.58x 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	23.42	21.58	18.05	18.88
	5-Year High	24.91	22.58	19.91	19.34
	5-Year Low	14.63	15.2	12.6	15.18
	5-Year Median	18.62	18.98	16.58	17.46
EV/EBITDA F12M	Current	16.44	12.81	17.82	12.66
	5-Year High	16.44	12.81	18.22	12.66
	5-Year Low	9.56	8.3	10.69	9.08
	5-Year Median	12.58	10.7	14.04	10.78
EV/Sales F12M	Current	4.37	2.78	3.14	3.26
	5-Year High	4.52	2.78	3.14	3.37
	5-Year Low	2.51	1.67	1.76	2.3
	5-Year Median	3.49	2.31	2.28	2.78

As of 02/05/2020

Industry Analysis Zacks Industry Rank: Bottom 16% (214 out of 255)



Top Peers

Applied Industrial Technologies, Inc. (AIT)	Neutral
Colfax Corporation (CFX)	Neutral
Dover Corporation (DOV)	Neutral
Eaton Corporation, PLC (ETN)	Neutral
General Electric Company (GE)	Neutral
Lincoln Electric Holdings, Inc. (LECO)	Neutral
The Middleby Corporation (MIDD)	Neutral
Parker-Hannifin Corporation (PH)	Neutral

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	ITW Neutral	X Industry	S&P 500	AIT Neutral	DOV Neutral	GE Neutral
VGM Score	D	-	-	A	A	D
Market Cap	59.70 B	1.98 B	24.26 B	2.64 B	17.32 B	112.31 B
# of Analysts	10	2.5	13	2	8	7
Dividend Yield	2.30%	0.00%	1.75%	1.82%	1.64%	0.31%
Value Score	D	-	-	A	C	D
Cash/Price	0.04	0.05	0.04	0.05	0.02	0.78
EV/EBITDA	15.92	13.31	14.19	10.22	16.04	-17.74
PEG Ratio	3.06	2.24	2.04	NA	1.64	3.20
Price/Book (P/B)	19.70	2.50	3.31	2.74	5.71	3.77
Price/Cash Flow (P/CF)	22.25	12.75	13.70	9.80	15.13	15.69
P/E (F1)	23.57	19.85	19.17	15.87	18.84	21.59
Price/Sales (P/S)	4.23	1.43	2.67	0.76	2.43	1.06
Earnings Yield	4.24%	5.01%	5.22%	6.30%	5.31%	4.67%
Debt/Equity	2.56	0.54	0.71	0.91	0.98	3.16
Cash Flow (\$/share)	8.35	2.62	6.92	6.96	7.88	0.82
Growth Score	B	-	-	B	A	B
Hist. EPS Growth (3-5 yrs)	11.96%	7.61%	10.80%	13.61%	11.69%	-20.84%
Proj. EPS Growth (F1/F0)	1.65%	7.88%	7.35%	-2.49%	6.73%	-8.35%
Curr. Cash Flow Growth	-11.27%	10.71%	10.12%	35.35%	10.20%	-48.47%
Hist. Cash Flow Growth (3-5 yrs)	2.28%	7.04%	8.55%	13.96%	1.28%	-19.88%
Current Ratio	2.90	2.03	1.20	2.72	1.46	1.84
Debt/Capital	71.90%	35.40%	42.91%	47.61%	49.61%	75.95%
Net Margin	17.87%	6.22%	11.79%	3.85%	9.50%	-4.71%
Return on Equity	81.83%	13.07%	17.21%	17.79%	29.46%	14.13%
Sales/Assets	0.93	0.81	0.54	1.46	0.82	0.37
Proj. Sales Growth (F1/F0)	-0.52%	1.86%	4.15%	-0.89%	2.25%	-13.78%
Momentum Score	F	-	-	D	A	F
Daily Price Chg	2.05%	0.97%	1.40%	1.46%	2.36%	2.23%
1 Week Price Chg	-0.75%	-1.95%	-2.60%	-1.88%	-2.78%	6.32%
4 Week Price Chg	3.93%	0.26%	1.96%	3.64%	2.43%	7.71%
12 Week Price Chg	7.14%	2.56%	6.04%	8.11%	9.23%	13.91%
52 Week Price Chg	35.03%	10.59%	16.68%	18.94%	35.57%	22.83%
20 Day Average Volume	1,329,166	37,840	1,966,046	208,131	865,355	61,335,448
(F1) EPS Est 1 week change	-0.35%	0.00%	0.00%	0.00%	0.52%	-5.94%
(F1) EPS Est 4 week change	-0.35%	0.00%	0.00%	-1.49%	0.56%	-15.07%
(F1) EPS Est 12 week change	-0.59%	-0.94%	-0.08%	-1.38%	0.20%	-15.76%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-3.52%	11.00%	-18.71%

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	D
Growth Score	B
Momentum Score	F
VGM Score	D

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.

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