Aug 06, 2020

Illinois Tool Works (ITW)

$188.53 (As of 08/05/20)

Price Target (6-12 Months): **$198.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 09/24/18) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:B
	Value: D | Growth: B	Momentum: A

Summary

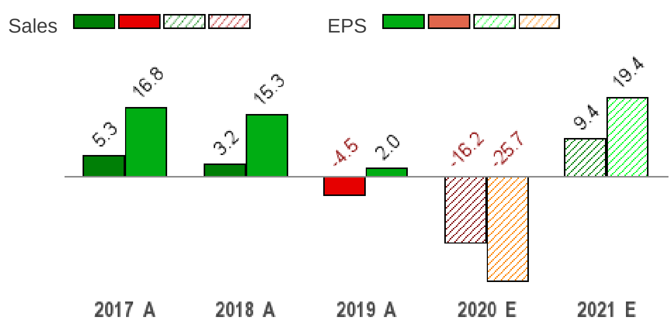
In the past three months, Illinois Tool's shares have outperformed the industry. The company is poised to gain from a diversified business structure, enterprise initiatives and the policy of rewarding shareholders handsomely. Its cost-reduction actions (savings in excess of $140 million were realized in the second quarter) will likely help in offsetting some of the pandemic-induced financial burdens. In second-quarter 2020, the company's earnings and sales surprised estimates by 55.71% and 8.66%, respectively. For 2020, the company kept its projection suspended due to the pandemic-related worries. However, based on scenarios analyst, the company's organic revenues (base case) will decline 12% in the second half of 2020 and 14.5% in 2020. Forex woes and high debts might be dragging too, though healthy liquidity is a relief.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$190.85 - $115.94**
20 Day Average Volume (sh)	**961,396**
Market Cap	**$59.6 B**
YTD Price Change	**5.0%**
Beta	**1.16**
Dividend / Div Yld	**$4.28 / 2.3%**
Industry	**Manufacturing - General Industrial**
Zacks Industry Rank	**Bottom 35% (164 out of 253)**
Last EPS Surprise	**55.7%**
Last Sales Surprise	**8.7%**
EPS F1 Est- 4 week change	**13.4%**
Expected Report Date	**10/23/2020**
Earnings ESP	**0.0%**
P/E TTM	**27.8**
P/E F1	**32.7**
PEG F1	**4.3**
P/S TTM	**4.7**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	3,264 E	3,072 E	3,161 E	3,341 E	12,937 E
2020	3,228 A	2,564 A	2,921 E	3,115 E	11,828 E
2019	3,552 A	3,609 A	3,479 A	3,469 A	14,109 A

EPS Estimates

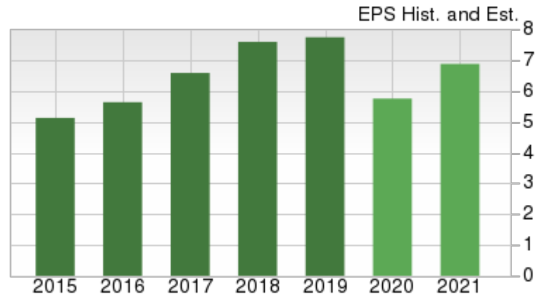
	Q1	Q2	Q3	Q4	Annual*
2021	$1.81 E	$1.61 E	$1.71 E	$1.83 E	$6.88 E
2020	$1.77 A	$1.09 A	$1.41 E	$1.58 E	$5.76 E
2019	$1.81 A	$2.00 A	$2.04 A	$1.88 A	$7.75 A

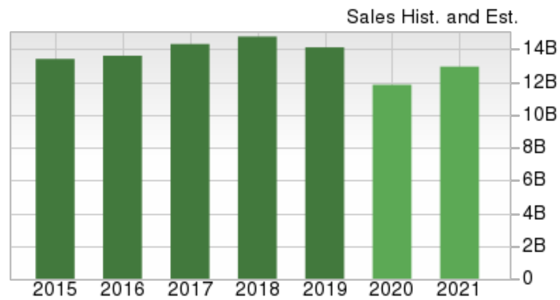
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/05/2020. The reports text is as of 08/06/2020.

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 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 past three months, Illinois Tool's shares have gained 20.1% compared with the industry's growth of 18.3%. The company anticipates benefiting from its diversified businesses, solid product offerings and healthy liquidity position (including $2.5 billion of revolving credit facility, $1.8 billion in available cash and no short-term debt) in the quarters ahead. Also, its enterprise strategy —including Business Structure Simplification, Portfolio Management and Strategic Sourcing — might be beneficial. Notably, the enterprise initiative contributed 100 bps to the operating margin in the second quarter of 2020. In the past seven days, the company's earnings estimates have been raised by 4.1% for the third quarter, 4.5% for 2020 and 1.2% for 2021.

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 dealing with the pandemic-induced financial burden.

- Illinois Tool's focus on continued supply of product in the pandemic era, innovation investments and initiatives by customers to build a localized supply chain are some important tailwinds for the near term. Also, the company is working diligently for the safety of its workers and management of its supply chain. Also, cost-reduction actions are being considered to mitigate some of the financial stress caused by the pandemic. In the second quarter, the company reduced its operating expenses in excess of $140 million.

- Illinois Tool remains committed to rewarding its shareholders substantially through dividend payments and share buybacks. In the second quarter of 2020, the company paid out dividends of $1.07 per share to its shareholders, while its diluted shares outstanding decreased 2.8% from 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.

Reasons To Sell:

- On a P/E (TTM) basis, Illinois Tool's shares currently seem to be overvalued compared with the industry, with respective tallies of 27.81X and 21.92X. Also, the industry's current multiple is higher than the industry's three-month highest level of 21.92X. In second-quarter 2020, the company's sales declined 29% from the year-ago quarter due mainly to a 26.5% fall in organic sales. Notably, organic sales declined in all segments — with a 53% fall recorded in Automotive OEM and a 38% decline in Food Equipment. Due to uncertainties related to the pandemic, the company refrained from reissuing its 2020 projections. However, based on the company's performance scenarios, its organic revenue (base-base) will decline 12% in the second half of 2020 and 14.5% in 2020.

The pandemic-related uncertainties remain concerning for Illinois Tool. Also, the company faces headwinds from forex woes and high debts.

- 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 second-quarter 2020, impact of negative foreign exchange lowered sales by 1.5%. Also, organic sales in North America were down 26%, while that in EMEA region decreased 37% and in APAC region was down 7%, partially offset by 1% growth in China sales.

- A highly leveraged balance sheet can inflate Illinois Tool's financial obligations and subsequently hurt profitability. In the last five years (2015-2019), the company's long-term debt increased 2.4% (CAGR). Long-term debt balance at the end of the second quarter of 2020 was $7,765 million. Its cash and cash equivalents was just $1,812 million at the end of the quarter. Another factor that is concerning is the company's ability to repay its obligations, as evident from a fall in times interest earned from 16.5X in the first quarter to 14.7X in the second quarter.

Last Earnings Report

Illinois Tool Q2 Earnings and Sales Beat Estimates

Quarter Ending	06/2020
Report Date	**Jul 31, 2020**
Sales Surprise	**8.66%**
EPS Surprise	**55.71%**
Quarterly EPS	**1.09**
Annual EPS (TTM)	**6.78**

Illinois Tool has delivered better-than-expected results for second-quarter 2020, with an earnings surprise of 55.71%. This was the eighth consecutive quarter of impressive results. Also, the quarter's sales surpassed estimate by 8.66%.

The industrial tool maker's earnings in the reported quarter were $1.09 per share, surpassing the Zacks Consensus Estimate of 70 cents. However, the bottom line declined from the year-ago reported number of $2.00.

Revenue Details

Illinois Tool generated revenues of $2,564 million in the reported quarter, reflecting a decline of 29% 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 26.5% drop in organic sales.

However, the top line surpassed the Zacks Consensus Estimate of $2,360 million.

Illinois Tool reports revenues under the segments discussed below:

Test & Measurement and Electronics' revenues in the second quarter decreased 14.7% year over year to $455 million. Revenues from **Automotive OEM** (Original Equipment Manufacturer) declined 54.1% to $361 million. **Food Equipment** generated revenues of $336 million, decreasing 38.6% year over year.

Welding revenues were $298 million, declining 29.4% year over year. **Construction Products**' revenues were down 11.4% to $376 million. Further, revenues of $387 million from **Specialty Products** reflected a decline of 18.2%. **Polymers & Fluids**' revenues of $354 million declined 17.2% year over year.

Margin Profile

In the reported quarter, Illinois Tool's cost of sales declined 24.1% year over year to $1,594 million. Selling, administrative, and research and development expenses declined 18.7% year over year to $486 million. It represented 19% of the second quarter's revenues.

Operating margin was 17.5% in the quarter, down from 24.1% reported in the year-ago quarter due to lower volumes. However, enterprise initiatives contributed 100 bps to operating margin and cost reduction of $140 million aided.

Interest expenses in the quarter declined 7.3% year over year to $51 million.

Balance Sheet and Cash Flow

Exiting the second quarter, Illinois Tool had cash and cash equivalents of $1,812 million, up 26.7% from $1,430 million recorded at the end of the last reported quarter. Long-term debt inched up 1% sequentially to $7,765 million.

In the second quarter, the company generated net cash of $737 million from operating activities, reflecting growth of 7.6% from the year-ago quarter. Capital spending on the purchase of plant and equipment was $56 million, down 27.3% year over year. Free cash flow was $681 million, reflecting a year-over-year increase of 12%.

In the second 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, cost-management actions and healthy liquidity position. However, due to uncertainties related to the pandemic, the company kept its 2020 projections suspended.

Recent News

Dividend

On **Jul 15, 2020**, Illinois Tool paid a quarterly dividend of $1.07 per share to shareholders of record as of Jun 30, 2020.

Valuation

Illinois Tool's shares increased 5% in the year-to-date period, while increased 26.5% in the trailing 12-month period. Stocks in the Zacks sub-industry are down 9%, while the Zacks Industrial Products sector decreased 6.5% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector increased 3.9% and 7.5%, respectively.

The S&P 500 Index has increased 2.6% in the year-to-date period and 15% in the past year.

The stock is currently trading at 30.8x forward 12-month earnings per share, which compares to 26.46x for the Zacks sub-industry, 21.38x for the Zacks sector and 22.58x 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 19.38x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $198 price target reflects 32.34x 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	30.8	26.46	21.38	22.58
	5-Year High	31.35	26.62	21.53	22.58
	5-Year Low	14.63	15.6	12.55	15.25
	5-Year Median	19.38	19.69	17.15	17.55
P/S F12M	Current	4.91	3.32	2.82	3.61
	5-Year High	4.91	3.32	2.82	3.61
	5-Year Low	2.11	1.58	1.52	2.53
	5-Year Median	3.23	2.25	2.03	3.04

As of 08/05/2020

Industry Analysis **Zacks Industry Rank:** Bottom 35% (164 out of 253)

Top Peers

Company (Ticker)	Rec	Rank
Atlas Copco AB **(ATLKY)**	Outperform	2
Dover Corporation **(DOV)**	Neutral	3
GEA GROUP AG SP **(GEAGY)**	Neutral	2
IHI CORP **(IHICY)**	Neutral	4
ParkerHannifin Corporation **(PH)**	Neutral	3
Roper Technologies, Inc. **(ROP)**	Neutral	3
SUMITOMO HEAVY **(SOHVY)**	Neutral	3
Tetra Tech, Inc. **(TTEK)**	Neutral	2

Industry Comparison Industry: Manufacturing - General Industrial

	ITW	X Industry	S&P 500	IHICY	PH	ROP
				Industry Peers		
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	3	3
VGM Score	B	-	-	A	B	D
Market Cap	59.56 B	1.24 B	22.93 B	2.02 B	23.80 B	45.44 B
# of Analysts	7	3	14	2	10	6
Dividend Yield	2.27%	0.00%	1.76%	1.03%	1.90%	0.47%
Value Score	D	-	-	A	B	D
Cash/Price	0.03	0.11	0.07	0.67	0.03	0.04
EV/EBITDA	16.65	12.15	13.16	2.82	12.15	17.21
PEG Ratio	4.28	3.24	2.99	NA	1.64	3.38
Price/Book (P/B)	25.26	1.91	3.20	0.62	3.77	4.60
Price/Cash Flow (P/CF)	20.54	11.10	12.45	3.08	11.92	25.23
P/E (F1)	32.46	26.67	21.78	NA	19.35	35.44
Price/Sales (P/S)	4.68	1.19	2.47	0.16	1.67	8.41
Earnings Yield	3.06%	3.27%	4.33%	-0.61%	5.17%	2.82%
Debt/Equity	3.29	0.50	0.77	0.65	1.28	0.53
Cash Flow ($/share)	9.18	2.49	6.94	1.06	15.57	17.25
Growth Score	B	-	-	B	B	C
Hist. EPS Growth (3-5 yrs)	10.21%	10.21%	10.46%	-32.02%	17.20%	20.23%
Proj. EPS Growth (F1/F0)	-25.71%	-24.63%	-7.14%	-116.67%	-1.50%	-5.90%
Curr. Cash Flow Growth	-2.44%	2.50%	5.47%	-25.60%	6.37%	11.79%
Hist. Cash Flow Growth (3-5 yrs)	4.24%	7.29%	8.55%	NA	7.55%	16.15%
Current Ratio	2.75	2.12	1.32	1.18	1.49	1.27
Debt/Capital	76.71%	34.31%	44.59%	39.54%	56.22%	34.76%
Net Margin	17.16%	4.34%	10.15%	0.92%	9.32%	29.75%
Return on Equity	81.80%	10.81%	14.46%	1.75%	24.30%	14.20%
Sales/Assets	0.87	0.77	0.51	0.82	0.72	0.30
Proj. Sales Growth (F1/F0)	-16.17%	-7.71%	-1.68%	-12.93%	0.45%	0.63%
Momentum Score	A	-	-	B	D	D
Daily Price Chg	1.86%	1.38%	0.59%	0.00%	2.40%	0.42%
1 Week Price Chg	0.11%	-1.68%	0.14%	-5.20%	-2.15%	4.14%
4 Week Price Chg	8.15%	5.37%	5.31%	-12.53%	3.62%	9.51%
12 Week Price Chg	23.63%	25.30%	19.84%	9.33%	26.45%	23.43%
52 Week Price Chg	26.51%	-3.01%	2.73%	-34.79%	12.73%	24.84%
20 Day Average Volume	961,396	71,710	2,098,555	17	890,947	442,587
(F1) EPS Est 1 week change	10.37%	0.00%	0.00%	0.00%	0.00%	0.78%
(F1) EPS Est 4 week change	13.36%	0.28%	1.10%	0.00%	1.51%	1.00%
(F1) EPS Est 12 week change	5.55%	0.62%	1.04%	-117.65%	2.87%	1.03%
(Q1) EPS Est Mthly Chg	20.64%	2.10%	0.39%	NA	6.06%	-2.72%

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	D
Growth Score	B
Momentum Score	A
VGM Score	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

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