

Illinois Tool Works (ITW)

\$158.78 (As of 05/06/20)

Price Target (6-12 Months): **\$167.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/27/18)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:C

Value: F

Growth: A

Momentum: B

Summary

Illinois Tool is poised to gain from a diversified business structure, enterprise initiatives and the policy of rewarding shareholders handsomely. Also, its cost-reduction actions will likely help in offsetting some of the pandemic-induced financial burdens. In first-quarter 2020, the company's earnings surpassed estimates by 3.5%, while sales lagged the same by 3.2%. 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.

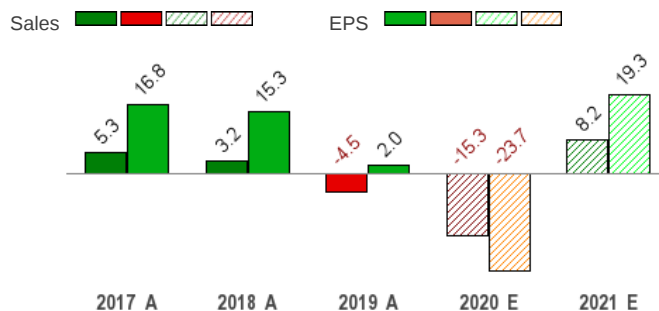
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$190.85 - \$115.94
20 Day Average Volume (sh)	1,456,306
Market Cap	\$50.4 B
YTD Price Change	-11.6%
Beta	1.16
Dividend / Div Yld	\$4.28 / 2.7%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 12% (222 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	-12.3%
Expected Report Date	07/24/2020
Earnings ESP	-3.8%
P/E TTM	20.7
P/E F1	26.9
PEG F1	3.5
P/S TTM	3.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	3,323 E	3,188 E	3,234 E	3,438 E	12,934 E
2020	3,228 A	2,648 E	2,817 E	3,164 E	11,955 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	\$1.72 E	\$1.77 E	\$1.79 E	\$1.87 E	\$7.05 E
2020	\$1.77 A	\$1.18 E	\$1.42 E	\$1.57 E	\$5.91 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 05/06/2020. The reports text is as of 05/07/2020.

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.

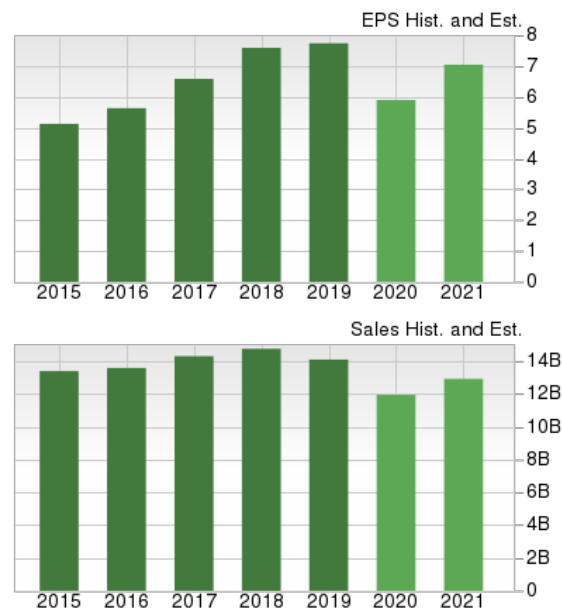
Polymers & Fluids (11.8%): This segment produces lubrication and cutting fluids, sealants, janitorial and hygiene products, adhesives, and fluids and polymers. It serves customers in general industrial, automotive aftermarket and other markets.

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.
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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 dipped 13.7% compared with the industry's decline of 22.1%. Also, on a P/E (TTM) basis, its shares currently seem to be overvalued compared with the industry, with respective tallies of 20.54x and 18.55x. 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 seven days, the company's earnings estimates have been lowered by 2.5% for 2020 and 1.3% 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 50.9%.

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

Valuation

Illinois Tool's shares are down 11.6% and up 5% in the year-to-date and the trailing 12-month periods, respectively. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are down 19.2% and 23.3% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 11.9% and 19.2%, respectively.

The S&P 500 index has declined 11.5% year to date and 1.3% in the past year.

The stock is currently trading at 24.67x forward 12-month earnings per share, which compares to 22.53x for the Zacks sub-industry, 18.07x for the Zacks sector and 20.52x for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.13x and as low as 14.63x, with a 5-year median of 18.83x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$167 price target reflects 25.90x 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	24.67	22.53	18.07	20.52
	5-Year High	26.13	23.5	19.93	20.52
	5-Year Low	14.63	15.6	12.55	15.19
	5-Year Median	18.83	19.44	16.56	17.44
EV/EBITDA F12M	Current	17.87	10.72	13.52	10.96
	5-Year High	17.88	14.04	18.17	14.17
	5-Year Low	9.56	8.2	10.58	9.07
	5-Year Median	12.87	11.09	14.08	10.84
EV/Sales F12M	Current	4.63	2.41	2.31	2.59
	5-Year High	4.74	3.28	3.12	3.52
	5-Year Low	2.51	1.81	1.76	2.3
	5-Year Median	3.57	2.59	2.29	2.81

As of 05/06/2020

Industry Analysis Zacks Industry Rank: Bottom 12% (222 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Colfax Corporation (CFX)	Neutral	4
Dover Corporation (DOV)	Neutral	4
Eaton Corporation PLC (ETN)	Neutral	4
General Electric Company (GE)	Neutral	3
The Middleby Corporation (MIDD)	Neutral	4
ParkerHannifin Corporation (PH)	Neutral	3
Applied Industrial Technologies Inc (AIT)	Underperform	4
Lincoln Electric Holdings Inc (LECO)	Underperform	5

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	ITW	X Industry	S&P 500	AIT	DOV	GE
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	4	4	3
VGM Score	C	-	-	A	D	F
Market Cap	50.42 B	1.07 B	19.11 B	1.98 B	13.01 B	52.31 B
# of Analysts	10	3	14	2	7	8
Dividend Yield	2.70%	0.00%	2.2%	2.50%	2.17%	0.67%
Value Score	F	-	-	A	D	C
Cash/Price	0.04	0.08	0.06	0.08	0.04	1.58
EV/EBITDA	14.26	9.97	11.69	8.08	12.46	2.65
PEG Ratio	3.50	2.53	2.48	NA	1.68	7.78
Price/Book (P/B)	22.07	1.67	2.58	2.38	4.36	1.42
Price/Cash Flow (P/CF)	17.30	8.10	10.40	7.34	11.47	4.64
P/E (F1)	26.92	19.69	18.81	13.84	19.32	44.71
Price/Sales (P/S)	3.66	0.95	1.97	0.58	1.84	0.53
Earnings Yield	3.72%	4.78%	4.99%	7.22%	5.18%	2.17%
Debt/Equity	3.37	0.48	0.75	1.04	0.99	1.80
Cash Flow (\$/share)	9.18	2.74	7.01	6.96	7.88	1.29
Growth Score	A	-	-	A	C	F
Hist. EPS Growth (3-5 yrs)	11.96%	10.39%	10.87%	14.14%	14.55%	-21.62%
Proj. EPS Growth (F1/F0)	-23.79%	-22.04%	-9.86%	-16.21%	-21.13%	-79.42%
Curr. Cash Flow Growth	-2.44%	4.08%	5.88%	35.35%	10.20%	-8.00%
Hist. Cash Flow Growth (3-5 yrs)	4.24%	4.95%	8.55%	13.96%	1.28%	-12.27%
Current Ratio	2.71	2.10	1.25	2.60	1.29	1.91
Debt/Capital	77.10%	33.00%	44.23%	51.01%	49.85%	64.30%
Net Margin	18.06%	6.05%	10.87%	0.99%	10.59%	-2.39%
Return on Equity	87.33%	10.81%	16.36%	17.40%	29.80%	13.66%
Sales/Assets	0.93	0.76	0.55	1.44	0.81	0.36
Proj. Sales Growth (F1/F0)	-15.27%	-7.89%	-2.18%	-5.97%	-10.52%	-22.51%
Momentum Score	B	-	-	A	D	F
Daily Price Chg	-0.57%	-0.09%	-1.27%	-1.29%	-1.65%	-3.55%
1 Week Price Chg	0.77%	1.68%	0.53%	6.63%	0.55%	3.83%
4 Week Price Chg	-0.01%	0.08%	0.68%	6.57%	0.86%	-18.08%
12 Week Price Chg	-16.29%	-27.40%	-22.30%	-27.40%	-24.60%	-54.56%
52 Week Price Chg	5.06%	-22.07%	-11.55%	-11.45%	-6.68%	-41.14%
20 Day Average Volume	1,456,306	69,433	2,470,143	227,988	1,010,870	121,609,936
(F1) EPS Est 1 week change	-2.53%	0.00%	0.00%	3.50%	0.00%	-57.20%
(F1) EPS Est 4 week change	-12.35%	-10.44%	-6.52%	3.50%	-15.33%	-68.62%
(F1) EPS Est 12 week change	-25.03%	-26.73%	-14.84%	-14.07%	-25.26%	-77.55%
(Q1) EPS Est Mthly Chg	-22.72%	-16.92%	-12.48%	19.13%	-38.68%	-276.28%

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	F
Growth Score	A
Momentum Score	B
VGM Score	C

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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