

Illinois Tool Works (ITW)

\$179.91 (As of 12/30/19)

Price Target (6-12 Months): **\$189.00**

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:B

Value: D

Growth: B

Momentum: A

Summary

In the past three months, Illinois Tool's shares have outperformed the industry. We believe that the company will gain from a diversified business structure, enterprise initiatives and the policy of rewarding shareholders handsomely. For 2019, it expects operating margin to benefit from a 100-bps contribution from enterprise initiatives. However, organic sales are predicted to decline 1-3% for the year. The company believes that macro uncertainties in the near term and adverse impacts of General Motors' strike might result in earnings coming in at the lower end of the projection of \$7.55-\$7.85 per share. Also, Illinois Tool faces risks from high debts, unfavorable movements in foreign currencies and restructuring expenses. The Zacks Consensus Estimate for the company's earnings for 2020 have been lowered in the past seven days.

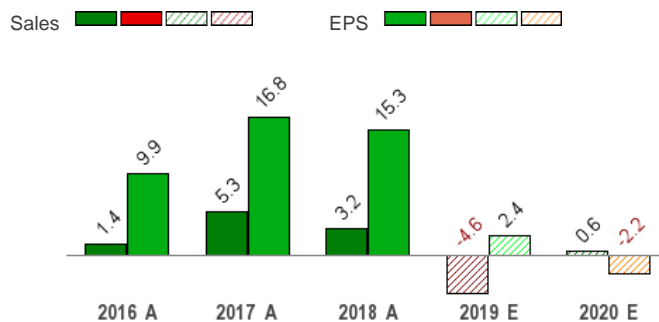
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$182.34 - \$122.58
20 Day Average Volume (sh)	963,006
Market Cap	\$57.8 B
YTD Price Change	42.0%
Beta	1.21
Dividend / Div Yld	\$4.28 / 2.4%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 30% (176 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.2%
Last Sales Surprise	-1.3%
EPS F1 Est- 4 week change	0.1%
Expected Report Date	02/07/2020
Earnings ESP	0.0%
P/E TTM	23.4
P/E F1	23.1
PEG F1	3.0
P/S TTM	4.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	3,505 E	3,614 E	3,526 E	3,505 E	14,170 E
2019	3,552 A	3,609 A	3,479 A	3,448 E	14,089 E
2018	3,744 A	3,831 A	3,613 A	3,580 A	14,768 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.86 E	\$1.87 E	\$2.03 E	\$2.04 E	\$7.61 E
2019	\$1.81 A	\$2.00 A	\$2.04 A	\$1.93 E	\$7.78 E
2018	\$1.90 A	\$1.97 A	\$1.90 A	\$1.83 A	\$7.60 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, except sales and EPS estimates, is as of 12/30/2019. The reports text and the analyst-provided sales and EPS estimates are as of 12/31/2019.

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 (14.5% of 2018 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 in automotive original equipment manufacturers, general industrial, consumer durables, electronics and other markets.

Automotive OEM (22.6%): This segment produces components and fasteners for automotive-related applications.

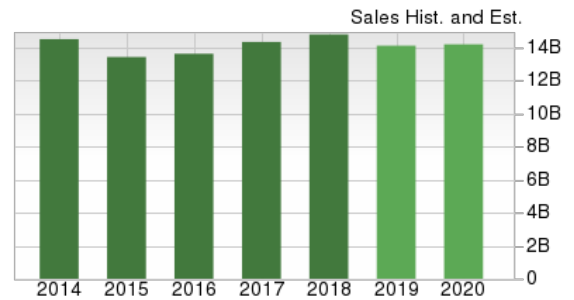
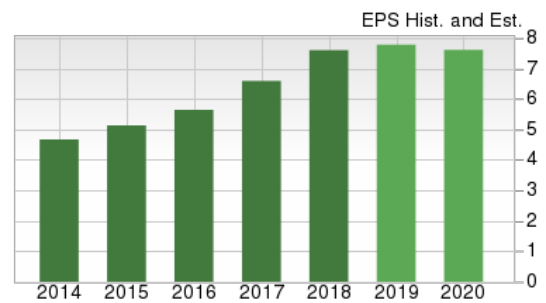
Polymers & Fluids (11.6%): This segment produces adhesives, sealants, lubrication and cutting fluids, janitorial and hygiene products, and fluids and polymers. It serves customers in general industrial, automotive aftermarket, construction and other markets.

Food Equipment (15%): 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 (11.4%): 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 (13.2%): This segment produces product coding and marking equipment and consumables, beverage packaging equipment and consumables, and appliance components and fasteners. Markets served include consumer durables, printing and publishing, food and beverage and other markets.



Reasons To Buy:

▲ In the past three months, Illinois Tool's shares have improved 17.8% compared with the industry's growth of 13.2%. In the third quarter of 2019, the company's earnings surpassed estimates by 5.2%. On a year-over-year basis, the bottom line grew 7.4% from the year-ago figure mainly on improved margin profile and a fall in share count. Notably, Enterprise initiatives contributed 120 bps to operating margin in the third quarter. It is worth noting here that 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 2019, Illinois Tool anticipates continued benefits from these initiatives, with contributions of 100 bps to operating margin. The company predicts operating margin (excluding restructuring activities) of 24.5% for 2019, with benefits from Enterprise initiatives and impact of improving price/costs.

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 shareholders handsomely through dividend payments and share buybacks. In the third quarter of 2019, the company repurchased shares worth \$375 million and paid out dividends of \$1.00 per share to shareholders. Notably, it raised the quarterly dividend rate by 7% in August 2019. Also, in August last year, a \$3-billion share buyback program was authorized. For 2019, the company anticipates buying back roughly \$1.5 billion shares. It intends to make more buybacks than the planned \$1.5 billion to negate the dilution caused by any divestment activities (explained below).

▲ 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.

▲ Illinois Tool 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 third quarter of 2019, Illinois Tool's revenues declined 3.7% year over year and lagged the Zacks Consensus Estimate by 1.2%. Organically, sales declined 1.7% year over year due to soft demand in the quarter. Notably, the company's organic performance in the Automotive OEM segment was adversely impacted by strike at General Motors. In addition, organic performance was weak in Food Equipment, Test & Measurement and Electronics, Welding, Construction Products, and Specialty Products segments. Also, Product Line Simplification ("PLS") initiatives had 0.6% adverse impact on the quarter's organic sales. For 2019, the company expects organic revenue decline of 1-3%, reflecting its concerns over demand level. Total revenues will likely be \$14-14.2 billion, down from the previously mentioned \$14.3-\$14.5 billion.
- ▼ Illinois Tool maintained its earnings guidance for 2019 at \$7.55-\$7.85 per share, with \$7.70 as the mid-point. The mid-point of \$7.70 includes the impact of higher restructuring and forex-related headwinds. Notably, macro uncertainties in the near term and adverse impacts of General Motors' strike will likely play spoilsport for the year, resulting in earnings at the lower end of the projection. Weakness in projections created bearish sentiments for the company's growth prospects. In the past seven days, the Zacks Consensus Estimate has been revised down 0.5% to \$1.93 for fourth quarter of 2019.
- ▼ 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 third-quarter 2019, impact of negative foreign exchange lowered sales by 1.8% and earnings by 5 cents per share. Also, business in Europe was down 2% while that in North America declined 2%. For 2019, forex woes are predicted to adversely influence 2019 results.
- ▼ A highly leveraged balance sheet can inflate Illinois Tool's financial obligations and subsequently hurt profitability. In five years (2014-2018), the company's long-term debt increased 0.3% (CAGR). Long-term debt balance at the end of the third quarter of 2019 was \$7,643 million, reflecting an increase of 26.8% 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 72%, higher than the industry's ratio of 47.3%.

Weak organic sales, restructuring expenses, forex woes and high debts may continue to dampen Illinois Tool's profitability in the upcoming quarters.

Last Earnings Report

Illinois Tool Q3 Earnings Beat Estimates, Revenues Lag

Illinois Tool has delivered better-than-expected results for third-quarter 2019, with a positive earnings surprise of 5.2%. This was the fifth consecutive quarter of impressive results.

The industrial tool maker's earnings in the reported quarter were \$2.04 per share, surpassing the Zacks Consensus Estimate of \$1.94. On a year-over-year basis, the bottom line grew 7.4% from the year-ago quarter figure of \$1.90, driven by margin improvement and a 3.4% fall in share count.

Notably, forex woes adversely impacted earnings by 5 cents per share.

Revenues Decline Y/Y

Illinois Tool generated revenues of \$3,479 million in the reported quarter, reflecting a decline of 3.7% from the year-ago figure. Top-line results were affected by a 1.8% impact of unfavorable foreign currency movement, 0.2% owing to acquisitions/divestitures, and 1.7% drop in organic sales (or declined 3.2% excluding the impact of gains from extra business days in the quarter). Product Line Simplification ("PLS") initiatives had adverse 0.6% impact on organic sales.

Further, the top line lagged the Zacks Consensus Estimate of \$3,523 million by 1.2%.

Illinois Tool reports revenues under the segments discussed below:

Test & Measurement, and Electronics' revenues in the third quarter declined 4.7% year over year to \$512 million. Revenues from Automotive OEM (Original Equipment Manufacturer) declined 4.7% to \$744 million. Food Equipment generated revenues of \$551 million, declining 2.7% year over year.

Welding revenues were \$402 million, declining 3% year over year. Construction Products' revenues were down 3.6% to \$416 million, while revenues of \$441 million from Specialty Products reflect a decline of 7.1%. Polymers & Fluids' revenues of \$418 million grew 0.8% year over year.

Operating Margin Improves

In the reported quarter, Illinois Tool's cost of sales declined 4.2% year over year to \$2,007 million. It represented 57.7% of the quarter's revenues versus 58% in the year-ago quarter. Selling, administrative, and research and development expenses dipped 2.6% year over year to \$566 million, while were 16.3% of the third quarter's revenues.

Operating margin was 25%, rising 40 basis points (bps) year over year. Enterprise initiatives contributed 120 bps to operating margin and price/costs had a positive impact of 20 bps. Interest expenses in the quarter declined 18.8% year over year to \$52 million.

Balance Sheet and Cash Flow

Exiting the third quarter, Illinois Tool had cash and cash equivalents of \$1,825 million, up 8.8% from \$1,677 million recorded at the end of the last reported quarter. Long-term debt declined 2.1% sequentially to \$7,643 million.

In the third quarter, the company generated net cash of \$920 million from operating activities, reflecting growth of 9% from the year-ago quarter. Capital spending on the purchase of plant and equipment was \$90 million, lower than \$101 million used in the year-ago quarter. Free cash flow was \$830 million, reflecting year-over-year growth of 11.7%.

In the quarter, the company bought back \$375 million worth of common shares, while increased quarterly dividend rate by 7%.

Outlook

For 2019, Illinois Tool maintained its GAAP earnings guidance at \$7.55-\$7.85 per share versus \$7.60 recorded in 2018. The mid-point of the projection is \$7.70, including the adverse impact of 30 cents (versus the previously stated 25 cents) from higher restructuring and forex-related headwinds.

The company anticipates organic revenue decline of 1-3%. Adverse impact of 70 bps (versus previously mentioned of 80 bps) is expected from PLS activities. Total revenues will likely be \$14-14.2 billion, down from the previously mentioned \$14.3-\$14.5 billion.

The company expects operating margin (excluding restructuring activities) of roughly 24.5%. The results will likely gain from more than 100 bps of contributions from enterprise initiatives, while price/costs will have positive impacts.

Free cash flow will likely be more than 100% of net income. The company is likely to buy back shares worth \$1.5 billion in the year.

Quarter Ending **09/2019**

Report Date	Oct 25, 2019
Sales Surprise	-1.26%
EPS Surprise	5.15%
Quarterly EPS	2.04
Annual EPS (TTM)	7.68

Recent News

Dividend

On **Oct 28, 2019**, Illinois Tool's board of directors approved the payment of a quarterly cash dividend of \$1.07 per share to shareholders of record as of Dec 31. The dividend will be paid out on Jan 15, 2020.

Valuation

Illinois Tool's shares are up 42% over the trailing 12-month periods. Over the past year, the Zacks sub-industry and the Zacks Industrial Products sector are up 35.4% and 23.5%, respectively.

The S&P 500 index has moved up 27.2% in the past year.

The stock is currently trading at 22.76x forward 12-month earnings per share, which compares to 21x for the Zacks sub-industry, 18.17x for the Zacks sector and 18.76x 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 18.52x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$189 price target reflects 23.91x 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	22.76	21	18.17	18.76
	5-Year High	24.91	22.52	19.88	19.34
	5-Year Low	14.63	15.16	12.58	15.17
	5-Year Median	18.52	18.89	16.43	17.43
EV/EBITDA F12M	Current	16.29	12.73	17.8	12.66
	5-Year High	16.29	12.73	18.18	12.66
	5-Year Low	9.71	8.25	10.66	9.08
	5-Year Median	12.72	10.59	13.97	10.78
EV/Sales F12M	Current	4.52	2.76	3.14	3.26
	5-Year High	4.52	2.77	3.14	3.37
	5-Year Low	2.51	1.66	1.76	2.3
	5-Year Median	3.48	2.3	2.27	2.78

As of 12/30/2019

Industry Analysis Zacks Industry Rank: Bottom 30% (176 out of 253)



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
The Middleby Corporation (MIDD)	Neutral
Parker-Hannifin Corporation (PH)	Neutral
Lincoln Electric Holdings, Inc. (LECO)	Underperform

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	ITW Neutral	X Industry	S&P 500	AIT Neutral	DOV Neutral	GE Neutral
VGM Score	B	-	-	A	B	C
Market Cap	57.82 B	1.84 B	23.75 B	2.58 B	16.74 B	96.77 B
# of Analysts		3	13	2		
Dividend Yield	2.38%	0.00%	1.79%	1.85%	1.70%	0.36%
Value Score	D	-	-	B	C	D
Cash/Price	0.03	0.05	0.04	0.04	0.02	0.78
EV/EBITDA	15.48	13.14	13.92	10.09	16.95	-14.39
PEG Ratio	2.99	2.38	2.12	NA	1.71	2.69
Price/Book (P/B)	19.47	2.62	3.32	2.79	5.55	3.32
Price/Cash Flow (P/CF)	19.74	12.82	13.73	9.60	16.24	6.94
P/E (F1)	23.05	19.85	19.56	15.31	19.71	18.16
Price/Sales (P/S)	4.07	1.36	2.67	0.75	2.33	0.86
Earnings Yield	4.23%	4.95%	5.10%	6.52%	5.08%	5.51%
Debt/Equity	2.57	0.57	0.72	0.93	0.96	2.67
Cash Flow (\$/share)	9.11	2.41	6.94	6.96	7.10	1.60
Growth Score	B	-	-	B	B	C
Hist. EPS Growth (3-5 yrs)	12.28%	5.37%	10.53%	12.71%	8.45%	-20.34%
Proj. EPS Growth (F1/F0)	0.10%	5.26%	6.30%	-1.02%	17.66%	-6.15%
Curr. Cash Flow Growth	10.04%	15.24%	14.83%	35.35%	12.99%	-18.18%
Hist. Cash Flow Growth (3-5 yrs)	6.16%	7.16%	9.00%	13.96%	-2.75%	-8.86%
Current Ratio	2.81	2.00	1.23	2.39	1.42	1.84
Debt/Capital	72.01%	36.19%	42.99%	48.10%	49.08%	72.76%
Net Margin	17.49%	6.39%	11.08%	3.86%	9.08%	-4.39%
Return on Equity	80.38%	12.61%	17.10%	18.22%	29.62%	11.69%
Sales/Assets	0.94	0.82	0.55	1.48	0.83	0.38
Proj. Sales Growth (F1/F0)	-4.59%	0.00%	2.86%	0.06%	-1.55%	-22.29%
Momentum Score	A	-	-	A	D	B
Daily Price Chg	-0.67%	0.00%	-0.43%	0.39%	-0.20%	-0.89%
1 Week Price Chg	0.45%	0.00%	0.13%	-0.11%	0.42%	1.36%
4 Week Price Chg	4.55%	2.55%	2.78%	5.08%	4.47%	-0.72%
12 Week Price Chg	19.78%	11.14%	8.67%	23.80%	21.77%	29.44%
52 Week Price Chg	42.01%	17.18%	27.07%	23.93%	62.42%	46.37%
20 Day Average Volume	963,006	50,072	1,731,328	191,049	667,597	45,782,112
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.06%	0.00%	0.00%	0.11%	0.00%	0.00%
(F1) EPS Est 12 week change	0.16%	-0.10%	0.14%	0.11%	0.32%	-3.17%
(Q1) EPS Est Mthly Chg	0.27%	0.00%	0.00%	0.00%	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	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.

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