



Illinois Tool Works (ITW)

Updated October 25th, 2018 by Nick McCullum

Key Metrics

Current Price:	\$120	5 Year CAGR Estimate:	12.8%	Volatility Percentile:	28.3%
Fair Value Price:	\$129	5 Year Growth Estimate:	8.0%	Momentum Percentile:	11.3%
% Fair Value:	93%	5 Year Valuation Multiple Estimate:	1.5%	Growth Percentile:	71.3%
Dividend Yield:	3.3%	5 Year Price Target	\$190	Valuation Percentile:	55.6%
Dividend Risk Score:	A	Retirement Suitability Score:	A	Total Return Percentile:	68.5%

Overview & Current Events

Illinois Tool Works is a diversified industrial manufacturer with a market capitalization of \$23 billion. The company has seven unique operating segments and generates more than half of its revenue from outside of the United States. Illinois Tool Works has increased its dividend for 54 consecutive years, which qualifies it to be a member of the Dividend Aristocrats Index.

In late October, Illinois Tool Works reported (10/24/18) financial results for the third quarter of fiscal 2018. In the quarter, Illinois Tool Works generated \$3.6 billion of revenue, which was flat on a GAAP basis due entirely to foreign exchange fluctuations. Including currency effects, Illinois Tools Works' generated organic revenue growth of 2% and North America growth of 4%. The company's operating margin of 24.6% expanded by 30 basis points year-on-year, while earnings-per-share of \$1.90 increased by 11% over the same period a year ago. Illinois Tool Works' current cost-cutting initiative, called Enterprise Initiatives, contributed 100 basis points of margin expansion, while pricing actions more than offset material cost on a dollar-for-dollar basis. Importantly, Illinois Tool Works continues to generate an appealing level of cash and returns much of this cash to shareholders. The company grew its free cash flow by 17% in the third quarter while repurchasing \$500 million of common equity and increasing its quarterly dividend payment by 28%.

Illinois Tool Works also narrowed its full-year financial guidance with the publication of its third quarter earnings release. The company now expects to generate earnings-per-share of \$7.55 to \$7.65 for the twelve-month reporting period, which represents 15% growth at the midpoint of the guidance range. We are leaving our 2018 earnings-per-share estimate unchanged as it sits squarely in the middle of the guidance band.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$3.05	\$1.93	\$3.03	\$3.74	\$4.09	\$3.63	\$4.67	\$5.13	\$5.70	\$6.64	\$7.60	\$11.18
DPS	\$1.18	\$1.24	\$1.30	\$1.40	\$1.48	\$1.60	\$1.75	\$2.07	\$2.40	\$2.73	\$4.00	\$6.44
Shares	499.1	502.3	497.7	483.6	455.1	430.2	382.9	363.7	346.9	341.5	330	300

Illinois Tool Works has compounded its earnings-per-share at a rate of 9.0% per year since 2008. Previously, we had estimated that a more moderate rate of growth (7%) was likely for this blue-chip Dividend Aristocrat. The company has since published targets for 8%-10% earnings-per-share growth through 2022, so we are increasing our 5-year growth estimate by one point to 8% per year.

Illinois Tool Works' current growth strategy is very straightforward; it simply needs to continue reinvesting in its current business. The company reported an after-tax return on invested capital of 28.0% in the third quarter, which implies that attractive returns can be achieved without venturing outside Illinois Tool Works' existing core competencies.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.9	20.1	15.4	13.7	13.9	19.4	18.5	17.0	19.0	21.5	15.7	17.0
Avg. Yld.	2.6%	3.2%	2.8%	2.7%	2.6%	1.7%	2.0%	2.2%	2.2%	1.9%	3.3%	2.4%

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Given the company's near-20% decline in stock price since the time of our last quarterly research report, Illinois Tool Works' valuation has improved significantly over the last three months. The company is trading at a current price-to-earnings ratio of 15.8. As we noted in our previously quarterly research reports on the company, our fair value target for Illinois Tool Works is a price-to-earnings ratio of 17. If the company's valuation multiple expands to 17 times earnings over the next 5 years, this will boost its total returns by 1.5% per year during this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

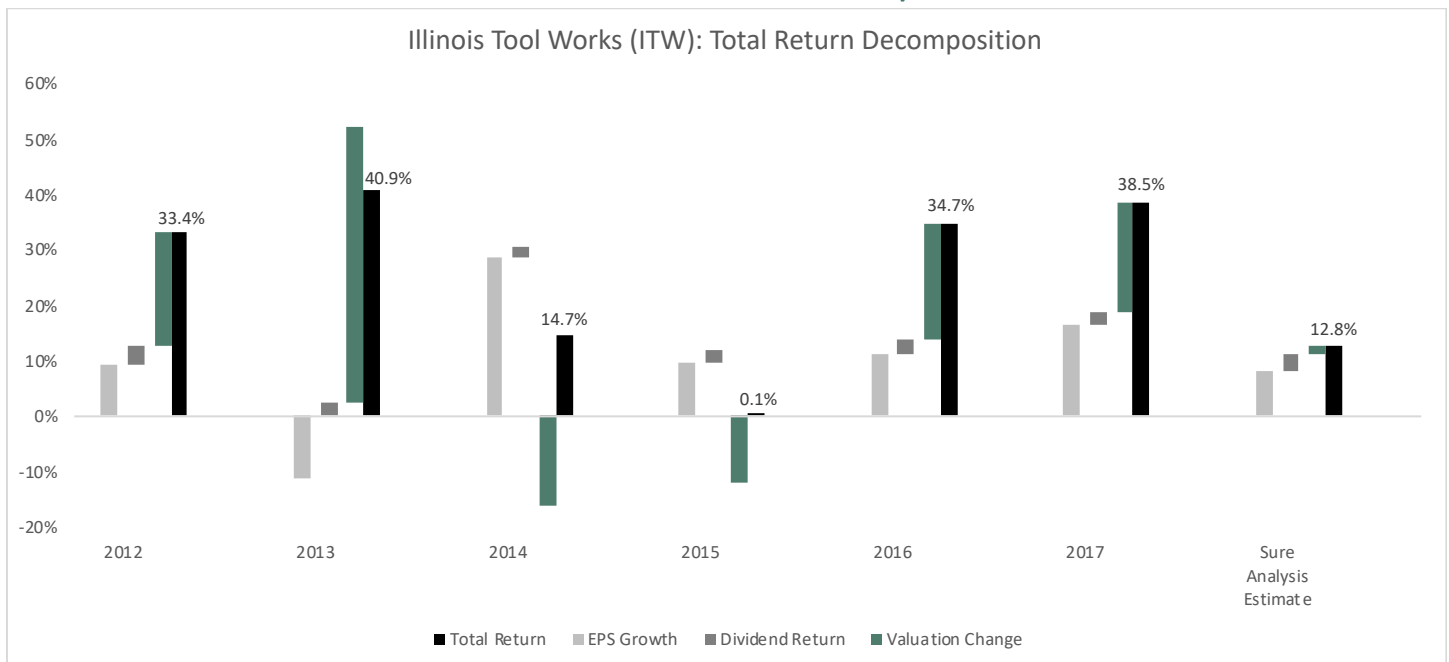
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	38.9%	29.4%	33.3%	30.2%	29.3%	28.0%	33.3%	35.1%	37.5%	35.8%	33.0%	33.0%
Debt/A	49.6%	45.2%	42.3%	44.3%	45.3%	51.4%	61.0%	66.8%	72.0%	72.7%	70.0%	55.0%
Int. Cov.	16.2	8.4	15.0	15.8	19.5	13.7	15.9	16.9	15.8	16.4	15.0	15.0
Payout	38.7%	64.2%	42.9%	37.4%	36.2%	44.1%	37.5%	40.4%	42.1%	41.1%	52.6%	57.6%
Std. Dev.	43.4%	37.4%	26.0%	32.3%	19.9%	16.1%	14.6%	18.7%	16.6%	13.7%	18.0%	18.0%

Illinois Tool Works' debt has increased over time, but its interest coverage remains robust. We continue to expect the company to deleverage as interest rates rise. Elsewhere, the company's gross profits as a percent of total assets is quite good. We note that the company has a sub-50% payout ratio, leaving room for healthy dividend growth moving forward. From a dividend perspective, Illinois Tool Works' long dividend history, reasonable payout ratio, and above-average dividend yield allow it to earn A ratings for both Dividend Safety and Retirement Suitability. When available at the right price, the company is an ideal investment for conservative, income-oriented investors.

Final Thoughts & Recommendation

Illinois Tool Works appears priced to deliver low double-digit total returns with relatively low risk. Accordingly, the company earns a buy recommendation from Sure Dividend, particularly for dividend growth investors looking to generate a reliable stream of growing dividend income over time.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	17100	13877	15416	14515	14791	14135	14484	13405	13599	14314
Gross Profit	5913	4732	5419	5426	5657	5581	5811	5517	5703	6005
Gross Margin	34.6%	34.1%	35.2%	37.4%	38.2%	39.5%	40.1%	41.2%	41.9%	42.0%
SG&A Exp.	3226	3037	2957	2846	2928	2815	2678	2417	2415	2400
D&A Exp.	692	675	549	594	613	613	507	477	470	462
Operating Profit	2503	1492	2255	2361	2477	2516	2888	2867	3064	3399
Op. Margin	14.6%	10.7%	14.6%	16.3%	16.7%	17.8%	19.9%	21.4%	22.5%	23.7%
Net Profit	1519	947	1503	2071	2870	1679	2946	1899	2035	1687
Net Margin	8.9%	6.8%	9.7%	14.3%	19.4%	11.9%	20.3%	14.2%	15.0%	11.8%
Free Cash Flow	1860	1899	1200	1603	1690	2160	1255	2015	2029	2105
Income Tax	660	244	637	448	973	717	809	820	873	1583

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	15204	16082	16250	17984	19309	19966	17465	15729	15201	16780
Cash & Equivalents	743	1319	1190	1178	2779	3618	3990	3090	2472	3094
Acc. Receivable	2572			2819	2742	2365	2293	2203	2357	2628
Inventories	1775	1356	1547	1716	1585	1247	1180	1086	1076	1220
Goodwill & Int.	6297	6584	6574	7431	7788	6885	6466	5999	6021	6024
Total Liabilities	7528	7264	6869	7950	8739	10257	10641	10501	10942	12191
Accounts Payable	684	690	754	697	676	634	512	449	511	590
Long-Term Debt	3682	3129	2830	3990	5048	6344	7419	7422	7829	8328
Total Equity	7663	8808	9370	10017	10561	9703	6819	5224	4254	4585
D/E Ratio	0.48	0.36	0.30	0.40	0.48	0.65	1.09	1.42	1.84	1.82

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	9.9%	6.1%	9.3%	12.1%	15.4%	8.6%	15.7%	11.4%	13.2%	10.6%
Return on Equity	17.9%	11.5%	16.5%	21.4%	27.9%	16.6%	35.7%	31.5%	42.9%	38.2%
ROIC	13.2%	8.1%	12.4%	15.8%	19.4%	10.6%	19.4%	14.1%	16.5%	13.5%
Shares Out.	499.1	502.3	497.7	483.6	455.1	430.2	382.9	363.7	346.9	341.5
Revenue/Share	32.97	27.65	30.63	29.35	31.26	31.46	35.80	36.22	38.08	41.27
FCF/Share	3.59	3.78	2.38	3.24	3.57	4.81	3.10	5.44	5.68	6.07

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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