



Illinois Tool Works Inc. (ITW)

Updated August 5th, 2021, by Eli Inkrot

Key Metrics

Current Price:	\$227	5 Year CAGR Estimate:	2.8%	Market Cap:	\$71 B
Fair Value Price:	\$166	5 Year Growth Estimate:	7.0%	Ex-Dividend Date¹:	09/29/21
% Fair Value:	137%	5 Year Valuation Multiple Estimate:	-6.0%	Dividend Payment Date¹:	10/14/21
Dividend Yield:	2.0%	5 Year Price Target	\$233	Years Of Dividend Growth:	46
Dividend Risk Score:	A	Retirement Suitability Score:	B	Last Dividend Increase:	6.5%

Overview & Current Events

Illinois Tool Works is a diversified multi-industrial manufacturer with seven unique operating segments: Automotive, Food Equipment, Test & Measurement, Welding, Polymers & Fluids, Construction Products and Specialty Products. Last year the company generated \$12.6 billion in revenue. The \$71 billion market cap company is geographically diversified, with more than half of its revenue generated outside of the United States. Illinois Tool Works has increased its dividend for 46 consecutive years, which qualifies the company to be a member of the Dividend Aristocrats Index.

On July 30th, 2021, Illinois Tool Works reported Q2 2021 results for the period ending June 30th, 2021. For the quarter revenue came in at \$3.676 billion, which was up 43.3% compared to Q2 2020, as the company lapped a difficult quarter in 2020. Sales were up across the board, with the Automotive segment up 95.3%. Net income equaled \$775 million or \$2.45 per share compared to \$319 million or \$1.01 per share in Q2 2020.

Illinois Tool Works also updated its 2021 guidance. The company now expects 11% to 13% organic growth and \$8.55 to \$8.95 in earnings-per-share (up from \$8.20 - \$8.60 and \$7.60 - \$8.00 previously). We have updated our forecast accordingly.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$3.74	\$4.09	\$3.63	\$4.67	\$5.13	\$5.70	\$6.78	\$7.60	\$7.74	\$6.63	\$8.75	\$12.27
DPS	\$1.40	\$1.48	\$1.60	\$1.75	\$2.07	\$2.40	\$2.73	\$3.56	\$4.14	\$4.42	\$4.56	\$6.10
Shares²	484	455	430	383	364	347	342	328	320	318	315	290

In the 2007 through 2019 period Illinois Tool Works increased its earnings-per-share by an average compound rate of 7.2% per annum. While there was cyclicity during the last recession, including a -40% drop in earnings from 2007 to 2009, generally the company has exhibited consistent progress. In the past Illinois Tool Works was able to grow via moderate top-line growth that was aided significantly by margin expansion (from 7% in 2009 to 18% in 2019) and share repurchases (reducing the share count by -35% since 2009). Last year results dipped -14% amid the pandemic.

Moving forward growth becomes a bit more difficult as the company gets larger. Still, the balance sheet is in good shape allowing for some flexibility from a capital allocation standpoint. Moreover, attractive returns can be achieved without venturing outside Illinois Tool Works' existing core competencies. Illinois Tool Works can continue to invest in its sales networks, R&D, and production capacity and the company's cost-cutting efforts could continue to buoy margins.

The business was tested in 2020, but management expects results to bounce back in short order in 2021. We are using the midpoint of management's guidance, \$8.75, along with a 7% expected annual growth rate over the intermediate term.

¹ Estimate

² In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	13.7	13.9	19.4	18.5	18.0	19.0	21.0	19.3	19.8	27.4	25.9	19.0
Avg. Yld.	2.7%	2.6%	1.7%	2.0%	2.2%	2.2%	1.9%	2.4%	2.7%	2.4%	2.0%	2.6%

Over the past decade shares of Illinois Tool Works have traded hands with an average P/E ratio of about 19 times earnings. We believe that a P/E ratio of 19 is a fair starting point, considering the quality of the business and growth prospects. With shares currently trading at 26 times the midpoint of management’s guidance, this implies the potential for a meaningful valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	37%	36%	44%	37%	40%	42%	40%	47%	53%	67%	52%	50%

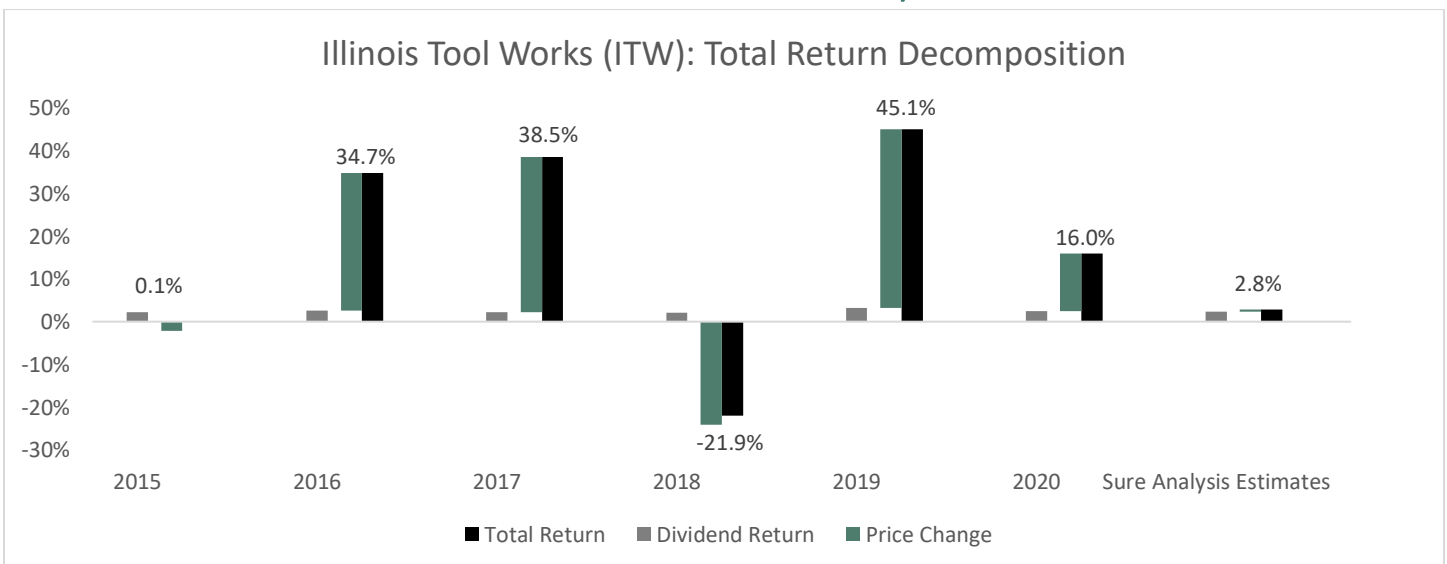
Illinois Tool Works has an excellent dividend growth history. Its payout ratio was relatively high during the last financial crisis, but the company was not forced to cut the payout. Today the dividend payout ratio sits just above 50% - the company’s long-term target – meaning that future dividend growth may trail earnings growth slightly.

Illinois Tool Works’ industry is not glamorous or one with outstanding growth rates, but the company has established itself as a major player that continues to grow profitably. Its experienced management and strong fundamentals, such as an above-average return on capital, function as competitive advantages. The company’s profits were reduced during the last financial crisis, posting earnings-per-share of \$3.36, \$3.05, \$1.93 and \$3.03 during the 2007 through 2010 stretch. This is something to consider for the next downturn, as the business was tested in 2020 as well.

Final Thoughts & Recommendation

After being up 17% in our last report, shares are down -4% in the last three months. Illinois Tool Works has several positives, including solid earnings growth, a nice dividend yield, a long and successful dividend growth history and a compelling long-term track record. However, total return potential comes in at 2.8% per annum, stemming from 7% growth and a 2.0% dividend yield offset by the possibility of a meaningful valuation headwind. We are enthused about the business, but we are less keen on the valuation. Shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	14515	14791	14135	14484	13405	13599	14314	14768	14109	12570
Gross Profit	5426	5657	5581	5811	5517	5703	6005	6164	5922	5199
Gross Margin	37.4%	38.2%	39.5%	40.1%	41.2%	41.9%	42.0%	41.7%	42.0%	41.4%
SG&A Exp.	2846	2928	2815	2678	2417	2415	2400	2391	2361	2163
D&A Exp.	594	613	613	507	477	470	462	---	---	427
Operating Profit	2361	2477	2516	2888	2867	3064	3399	3584	3402	2882
Op. Margin	16.3%	16.7%	17.8%	19.9%	21.4%	22.5%	23.7%	24.3%	24.1%	22.9%
Net Profit	2071	2870	1679	2946	1899	2035	1687	2563	2521	2109
Net Margin	14.3%	19.4%	11.9%	20.3%	14.2%	15.0%	11.8%	17.4%	17.9%	16.8%
Free Cash Flow	1603	1690	2160	1255	2015	2029	2105	---	---	2571
Income Tax	448	973	717	809	820	873	1583	831	767	595

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	17984	19309	19966	17465	15729	15201	16780	14870	15068	15610
Cash & Equivalents	1178	2779	3618	3990	3090	2472	3094	1504	1981	2564
Acc. Receivable	2819	2742	2365	2293	2203	2357	2628	2622	2461	2506
Inventories	1716	1585	1247	1180	1086	1076	1220	1318	1164	1189
Goodwill & Int.	7431	7788	6885	6466	5999	6021	6024	5717	5343	5471
Total Liabilities	7950	8739	10257	10641	10501	10942	12191	11612	12038	12430
Accounts Payable	697	676	634	512	449	511	590	524	472	534
Long-Term Debt	3990	5048	6344	7419	7422	7829	8328	7380	7758	8122
Total Equity	10017	10561	9703	6819	5224	4254	4585	3254	3026	3181
D/E Ratio	0.40	0.48	0.65	1.09	1.42	1.84	1.82	2.27	2.56	2.56

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	12.1%	15.4%	8.6%	15.7%	11.4%	13.2%	10.6%	16.2%	16.8%	13.8%
Return on Equity	21.4%	27.9%	16.6%	35.7%	31.5%	42.9%	38.2%	65.4%	80.3%	68.0%
ROIC	15.8%	19.4%	10.6%	19.4%	14.1%	16.5%	13.5%	21.8%	23.5%	19.1%
Shares Out.	484	455	430	383	364	347	342	328	320	318
Revenue/Share	29.35	31.26	31.46	35.80	36.22	38.08	41.27	43.81	43.33	39.5
FCF/Share	3.24	3.57	4.81	3.10	5.44	5.68	6.07	---	---	8.08

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

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