



Illinois Tool Works Inc. (ITW)

Updated October 28th, 2022 by Quinn Mohammed

Key Metrics

Current Price:	\$214	5 Year CAGR Estimate:	6.0%	Market Cap:	\$66 B
Fair Value Price:	\$184	5 Year Growth Estimate:	7.0%	Ex-Dividend Date¹:	12/29/22
% Fair Value:	116%	5 Year Valuation Multiple Estimate:	-3.0%	Dividend Payment Date¹:	01/12/22
Dividend Yield:	2.3%	5 Year Price Target	\$258	Years Of Dividend Growth:	58
Dividend Risk Score:	A	Retirement Suitability Score:	B	Rating:	Hold

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 \$14.5 billion in revenue. The \$66 billion market cap company is geographically diversified, with more than half of its revenue generated outside of the United States. Illinois Tool Works is a member of the Dividend Aristocrats Index and is a Dividend King.

On October 25th, 2022, Illinois Tool Works reported third quarter 2022 results for the period ending September 30th, 2022. For the quarter, revenue came in at \$4.0 billion, up 13% year-over-year. Sales were up 25% in the Automotive OEM segment, the largest out of the company's seven segments. Five out of these seven segments had double-digit organic sales growth in the quarter. Net income equaled \$727 million or \$2.35 per share compared to \$639 million or \$2.02 per share in Q3 2021.

Illinois Tool Works updated its 2022 guidance and now sees full-year GAAP EPS to be between \$9.45 and \$9.55. We have upgraded our 2022 estimate to reflect this.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$4.09	\$3.63	\$4.67	\$5.13	\$5.70	\$6.78	\$7.60	\$7.74	\$6.63	\$8.51	\$9.45	\$13.25
DPS	\$1.48	\$1.60	\$1.75	\$2.07	\$2.40	\$2.73	\$3.56	\$4.14	\$4.42	\$4.72	\$4.88	\$6.08
Shares²	455	430	383	364	347	342	328	320	318	315	310.0	285.0

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 great 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 and share repurchases.

Results for 2020 dipped -14% amid the pandemic, but 2021 bounced back materially. 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.

We are using the low point of management's guidance, \$9.45, along with a 7.0% expected annual growth rate over the intermediate term. This is at the low end of the company's 7% to 10% annual EPS growth, but we prefer to remain cautious.

¹ Estimated date.

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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	13.9	19.4	18.5	18.0	19.0	21.0	19.3	19.8	27.4	25.7	22.7	19.5
Avg. Yld.	2.6%	1.7%	2.0%	2.2%	2.2%	1.9%	2.4%	2.7%	2.4%	2.2%	2.3%	2.4%

Over the past decade shares of Illinois Tool Works have traded hands with an average P/E ratio of about 20 times earnings. We believe that a P/E ratio of 19.5 is a fair starting point, considering the quality of the business and growth prospects. With shares currently trading near 23 times the midpoint of management's guidance, this implies the potential for a valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	36%	44%	37%	40%	42%	40%	47%	53%	67%	55%	52%	46%

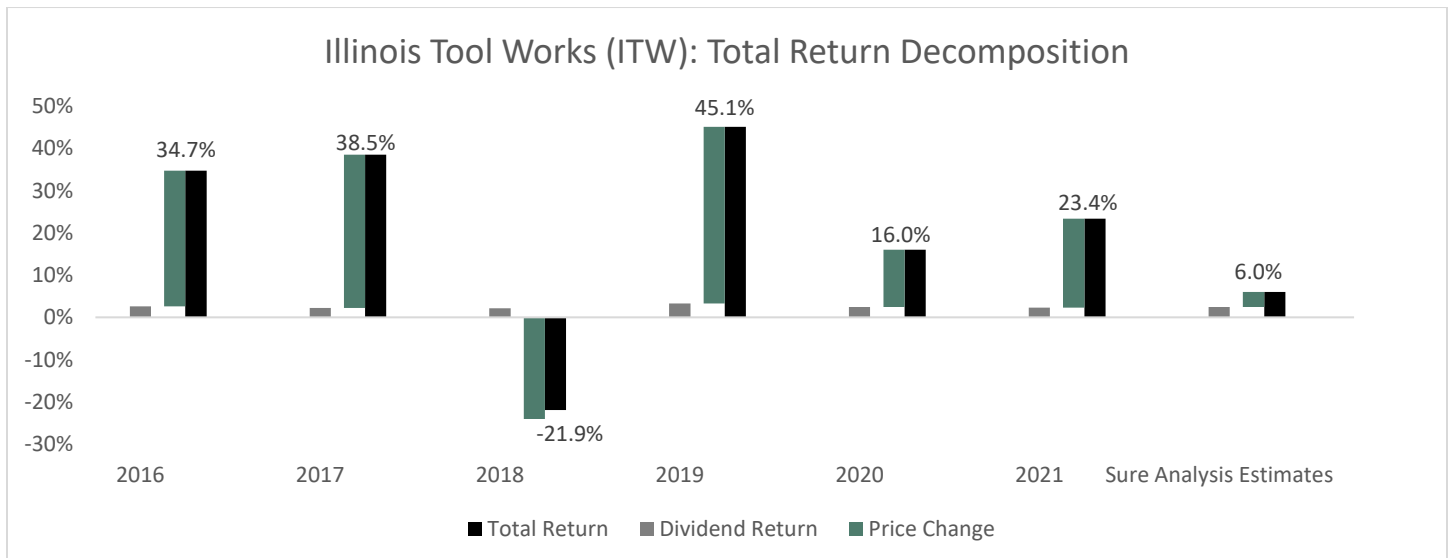
Illinois Tool Works has an excellent dividend growth history. Its payout ratio was relatively high during the last financial crisis, but the company was not forced to cut the payout. Today the dividend payout ratio sits at 53% of expected earnings, above the company's long-term target, meaning that future dividend growth may trail earnings growth.

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

Shares are down 12% year-to-date, which is favorable compared to the broader market's 19% loss. 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 6.0% per annum, stemming from 7.0% growth and a 2.3% dividend yield offset by the possibility of a 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	14791	14135	14484	13405	13599	14314	14768	14109	12570	14460
Gross Profit	5657	5581	5811	5517	5703	6005	6164	5922	5199	5966
Gross Margin	38.2%	39.5%	40.1%	41.2%	41.9%	42.0%	41.7%	42.0%	41.4%	41.3%
SG&A Exp.	2928	2815	2678	2417	2415	2400	2391	2361	2163	2356
D&A Exp.	613	613	507	477	470	462	---	---	427	---
Operating Profit	2477	2516	2888	2867	3064	3399	3584	3402	2882	3477
Op. Margin	16.7%	17.8%	19.9%	21.4%	22.5%	23.7%	24.3%	24.1%	22.9%	24.0%
Net Profit	2870	1679	2946	1899	2035	1687	2563	2521	2109	2694
Net Margin	19.4%	11.9%	20.3%	14.2%	15.0%	11.8%	17.4%	17.9%	16.8%	18.6%
Free Cash Flow	1690	2160	1255	2015	2029	2105	---	---	2571	---
Income Tax	973	717	809	820	873	1583	831	767	595	632

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	19309	19966	17465	15729	15201	16780	14870	15068	15610	16080
Cash & Equivalents	2779	3618	3990	3090	2472	3094	1504	1981	2564	1527
Acc. Receivable	2742	2365	2293	2203	2357	2628	2622	2461	2506	2840
Inventories	1585	1247	1180	1086	1076	1220	1318	1164	1189	1694
Goodwill & Int.	7788	6885	6466	5999	6021	6024	5717	5343	5471	5937
Total Liabilities	8739	10257	10641	10501	10942	12191	11612	12038	12430	12450
Accounts Payable	676	634	512	449	511	590	524	472	534	585
Long-Term Debt	5048	6344	7419	7422	7829	8328	7380	7758	8122	7687
Total Equity	10561	9703	6819	5224	4254	4585	3254	3026	3181	3625
LTD/E Ratio	0.48	0.65	1.09	1.42	1.84	1.82	2.27	2.56	2.56	2.12

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	15.4%	8.6%	15.7%	11.4%	13.2%	10.6%	16.2%	16.8%	13.8%	17.0%
Return on Equity	27.9%	16.6%	35.7%	31.5%	42.9%	38.2%	65.4%	80.3%	68.0%	79.2%
ROIC	19.4%	10.6%	19.4%	14.1%	16.5%	13.5%	21.8%	23.5%	19.1%	23.8%
Shares Out.	455	430	383	364	347	342	328	320	318	316
Revenue/Share	31.26	31.46	35.80	36.22	38.08	41.27	43.81	43.33	39.5	45.69
FCF/Share	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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