

ILLINOIS TOOL WORKS INC

Form 10-K

February 15, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-4797

ILLINOIS TOOL WORKS INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware 36-1258310
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

155 Harlem Avenue, Glenview, Illinois 60025
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (847) 724-7500

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock	New York Stock Exchange
1.75% Euro Notes due 2022	New York Stock Exchange
1.25% Euro Notes due 2023	New York Stock Exchange
2.125% Euro Notes due 2030	New York Stock Exchange
3.00% Euro Notes due 2034	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer,"

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"accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2018 was approximately \$43.5 billion based on the New York Stock Exchange closing sales price as of June 30, 2018.

Shares of Common Stock outstanding at January 31, 2019: 328,108,383.

Documents Incorporated by Reference

Portions of the 2019 Proxy Statement for Annual Meeting of Stockholders to be held on May 3, 2019. Part III

Table of Contents

<u>PART I</u>	
<u>Item 1. Business</u>	<u>3</u>
<u>Item 1A. Risk Factors</u>	<u>10</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>14</u>
<u>Item 2. Properties</u>	<u>14</u>
<u>Item 3. Legal Proceedings</u>	<u>15</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>15</u>
<u>PART II</u>	
<u>Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>16</u>
<u>Item 6. Selected Financial Data</u>	<u>17</u>
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>40</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>42</u>
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>76</u>
<u>Item 9A. Controls and Procedures</u>	<u>76</u>
<u>Item 9B. Other Information</u>	<u>76</u>
<u>PART III</u>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>77</u>
<u>Item 11. Executive Compensation</u>	<u>77</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>77</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>77</u>
<u>Item 14. Principal Accounting Fees and Services</u>	<u>77</u>
<u>PART IV</u>	
<u>Item 15. Exhibits and Financial Statement Schedules</u>	<u>78</u>
<u>Item 16. Form 10-K Summary</u>	<u>81</u>
<u>Signatures</u>	<u>82</u>

PART I

ITEM 1. Business

General

Illinois Tool Works Inc. (the "Company" or "ITW") was founded in 1912 and incorporated in 1915. The Company's ticker symbol is ITW. The Company is a global manufacturer of a diversified range of industrial products and equipment with 87 divisions in 55 countries. As of December 31, 2018, the Company employed approximately 48,000 people.

The Company's operations are organized and managed based on similar product offerings and end markets, and are reported to senior management as the following seven segments: Automotive OEM; Food Equipment; Test & Measurement and Electronics; Welding; Polymers & Fluids; Construction Products; and Specialty Products. The following is a description of the Company's seven segments:

Automotive OEM— This segment is a global, niche supplier to top tier OEMs, providing unique innovation to address pain points for sophisticated customers with complex problems. Businesses in this segment produce components and fasteners for automotive-related applications. This segment primarily serves the automotive original equipment manufacturers and tiers market. Products in this segment include:

plastic and metal components, fasteners and assemblies for automobiles, light trucks and other industrial uses.

Food Equipment— This segment is a highly focused and branded industry leader in commercial food equipment differentiated by innovation and integrated service offerings. This segment primarily serves the food service, food institutional/restaurant and food retail markets. Products in this segment include:

- warewashing equipment;
- cooking equipment, including ovens, ranges and broilers;
- refrigeration equipment, including refrigerators, freezers and prep tables;
- food processing equipment, including slicers, mixers and scales;
- kitchen exhaust, ventilation and pollution control systems; and
- food equipment service, maintenance and repair.

Test & Measurement and Electronics— This segment is a branded and innovative producer of test and measurement and electronic manufacturing and maintenance, repair, and operations, or "MRO" solutions that improve efficiency and quality for customers in diverse end markets. Businesses in this segment produce equipment, consumables, and related software for testing and measuring of materials and structures, as well as equipment and consumables used in the production of electronic subassemblies and microelectronics. This segment primarily serves the electronics, general industrial, industrial capital goods, automotive original equipment manufacturers and tiers, and consumer durables markets. Products in this segment include:

- equipment, consumables, and related software for testing and measuring of materials, structures, gases and fluids;
- electronic assembly equipment and related consumable solder materials;
- electronic components and component packaging;
- static control equipment and consumables used for contamination control in clean room environments;
- and
- pressure sensitive adhesives and components for electronics, medical, transportation and telecommunications applications.

Welding— This segment is a branded value-added equipment and specialty consumable manufacturer with innovative and leading technology. Businesses in this segment produce arc welding equipment, consumables and accessories for a wide array of industrial and commercial applications. This segment primarily serves the general industrial market, which includes fabrication, shipbuilding and other general industrial markets, and energy, construction, MRO, automotive original equipment manufacturers and tiers, and industrial capital goods markets. Products in this segment include:

- arc welding equipment;
- metal arc welding consumables and related accessories; and
- metal jacketing and other insulation products.

Polymers & Fluids— This segment is a branded supplier to niche markets that require value-added, differentiated products. Businesses in this segment produce engineered adhesives, sealants, lubrication and cutting fluids, and fluids and polymers for auto aftermarket maintenance and appearance. This segment primarily serves the automotive aftermarket, general industrial, MRO and construction markets. Products in this segment include:

- adhesives for industrial, construction and consumer purposes;
- chemical fluids which clean or add lubrication to machines;
- epoxy and resin-based coating products for industrial applications;
- hand wipes and cleaners for industrial applications;
- fluids, polymers and other supplies for auto aftermarket maintenance and appearance;
- fillers and putties for auto body repair; and
- polyester coatings and patch and repair products for the marine industry.

Construction Products— This segment is a branded supplier of innovative engineered fastening systems and solutions. This segment primarily serves the residential construction, renovation/remodel and commercial construction markets. Products in this segment include:

- fasteners and related fastening tools for wood and metal applications;
- anchors, fasteners and related tools for concrete applications;
- metal plate truss components and related equipment and software; and
- packaged hardware, fasteners, anchors and other products for retail.

Specialty Products— This segment is focused on diversified niche market opportunities with substantial patent protection producing beverage packaging equipment and consumables, product coding and marking equipment and consumables, and appliance components and fasteners. This segment primarily serves the food and beverage, consumer durables, general industrial, printing and publishing and industrial capital goods markets. Products in this segment include:

- line integration, conveyor systems and line automation for the food and beverage industries;
- plastic consumables that multi-pack cans and bottles and related equipment;
- foil, film and related equipment used to decorate consumer products;
- product coding and marking equipment and related consumables;
- plastic and metal closures and components for appliances;
- airport ground support equipment; and
- components for medical devices.

The information set forth below is applicable to all segments of the Company unless otherwise noted.

The ITW Business Model

The powerful and highly differentiated ITW Business Model is the Company's core source of value creation. This business model is the Company's competitive advantage and defines how ITW creates value for its shareholders and comprises three unique elements:

ITW's 80/20 Front-to-Back process is the operating system that is applied in every ITW business. Initially introduced as a manufacturing efficiency tool in the 1980s, ITW has continually refined, improved and expanded 80/20 into a proprietary, holistic business management process that generates significant value for the Company and its customers. Through the application of data driven insights generated by 80/20 practice, ITW focuses on its largest and best opportunities (the "80") and eliminates cost, complexity and distractions associated with the less profitable opportunities

(the “20”). 80/20 enables ITW businesses to consistently achieve world-class operational excellence in product availability, quality, and innovation, while generating superior financial performance;

Customer-back Innovation has fueled decades of profitable growth at ITW. The Company’s unique innovation approach is built on insight gathered from the 80/20 Front-to-Back process. Working from the customer back, ITW businesses position themselves as the go-to problem solver for their “80” customers. ITW’s innovation efforts are focused on understanding customer needs, particularly those in “80” markets with solid long-term growth fundamentals, and subsequently creating unique solutions to address those needs. These customer insights and learnings drive innovation at ITW and have contributed to a portfolio of approximately 18,000 granted and pending patents;

ITW's Decentralized, Entrepreneurial Culture enables ITW businesses to be fast, focused, and responsive. ITW businesses have significant flexibility within the framework of the ITW Business Model to customize their approach in order to best serve their specific customers' needs. ITW colleagues recognize their unique responsibilities to execute the Company's strategy and values. As a result, the Company maintains a focused and simple organizational structure that, combined with outstanding execution, delivers best-in-class services and solutions adapted to each business' customers and end markets.

Enterprise Strategy

In late 2012, ITW began its strategic framework transitioning the Company on its current path to fully leverage the compelling performance potential of the ITW Business Model. Since then, ITW has made considerable progress in its path to full potential.

The roots of ITW's Enterprise Strategy began in late 2011 / early 2012, when the Company undertook a complete review of its performance. Focusing on its businesses delivering consistent above-market growth with best-in-class margins and returns, ITW developed a strategy to replicate that performance across its operations.

Based on this rigorous evaluation, ITW determined that solid and consistent above-market organic growth must be the core growth engine to deliver world-class financial performance and compelling long-term returns for its shareholders. To shift its primary growth engine to organic, the Company began executing a multi-step approach.

The first step was to narrow the focus and improve the quality of ITW's business portfolio. As part of the Portfolio Management initiative, ITW exited businesses that were operating in commoditized market spaces and prioritized sustainable differentiation as a must-have requirement for all ITW businesses. This process included both divesting entire businesses and exiting commoditized product lines and customers inside otherwise highly differentiated ITW divisions.

As a result of this work, ITW's business portfolio now has significantly higher organic growth potential. ITW segments and divisions now possess attractive and differentiated product lines and end markets as they continue to improve operating margins and generate price/cost increases. The Company achieved this through product line simplification, or eliminating the complexity and overhead costs associated with smaller product lines and customers, while supporting and growing the businesses' largest / most profitable customers and product lines.

Step two, Business Structure Simplification, was implemented to simplify and scale-up ITW's operating structure to support increased engineering, marketing, and sales resources, and, at the same time, improve global reach and competitiveness, all of which were critical to driving accelerated organic growth. ITW now has 87 scaled-up divisions with significantly enhanced focus on growth investments, core customers and products, and customer-back innovation.

The Strategic Sourcing initiative established sourcing as a core strategic and operational capability at ITW. The Company's 80/20-enabled sourcing organization has delivered an average of one percent reduction in spend each year from 2013 through 2018 and is on track to do the same in 2019.

With the initial portfolio realignment and scale-up work largely complete, the Company has shifted its focus to preparing for and accelerating organic growth, reapplying the 80/20 Front-to-Back process to optimize its newly scaled-up divisions for growth, first, to build a foundation of operational excellence, and second, to identify the best opportunities to drive organic growth.

ITW has clearly demonstrated superior 80/20 management, resulting in meaningful incremental improvement in margins and returns as evidenced by the Company's operating margin and after-tax return on invested capital. At the same time, these 80/20 initiatives can also result in restructuring initiatives that reduce costs and improve profitability and returns.

Path to Full Potential - Finishing the Job

Since the launch of the enterprise strategy, the Company has made considerable progress to position itself to reach full potential. The ITW Business Model and unique set of capabilities are a source of strong and enduring competitive advantage, but for the Company to truly reach its full potential over the next five years, every one of its divisions must also be operating at its full potential. To do so, the Company remains focused on three key areas to finish the job of positioning ITW to perform to its full potential:

- Portfolio discipline
- 80/20 Front-to-Back practice excellence
- Full-potential organic growth

Portfolio Discipline

The Company only operates in industries where it can generate significant, long-term competitive advantage from the ITW Business Model. ITW businesses have the right “raw material” in terms of market and business attributes that best fit the ITW Business Model and have significant potential to drive above-market organic growth over the long-term.

The Company focuses on high-quality businesses, ensuring it operates in markets with positive long-term macro fundamentals and with customers that have critical needs and value ITW's differentiated products, services and solutions. ITW's portfolio operates in diverse end markets and geographies which makes the Company more resilient in the face of uncertain or volatile market environments.

80/20 Front-to-Back Practice Excellence

The 80/20 Front-to-Back process is a rigorous, iterative and highly data-driven approach to identify where the Company has true differentiation and the ability to drive sustainable, high-quality organic growth. The Company simplifies and eliminates complexity and redesigns every aspect of its business to ensure focused execution on key opportunities, markets, customers, and products. ITW will continue its efforts to drive 80/20 Front-to-Back practice excellence in every division in the Company, every day.

Full-potential Organic Growth

Reaching full potential means that every division is positioned for sustainable, high-quality organic growth. The Company has clearly defined action plans aimed at leveraging the performance power of the ITW Business Model to achieve full-potential organic growth in every division. At the same time, the Company consistently reviews its portfolio, assesses businesses that are growth-challenged and evaluates if further portfolio refinements may be needed. The Company is currently exploring options, including potential divestitures, for certain businesses with revenues totaling up to \$1 billion. If a decision is made to divest any of these businesses, the Company expects that earnings per share dilution would be offset by incremental share repurchases.

Divestiture Activity

Divestiture of the Industrial Packaging Segment— In February 2013, the Company announced that it was initiating a review process to explore strategic alternatives for the Industrial Packaging segment. In September 2013, the Company's Board of Directors authorized a plan to commence a sale process for the Industrial Packaging segment. The Company classified the Industrial Packaging segment as held for sale beginning in the third quarter of 2013 and no longer presented this segment as part of its continuing operations.

On February 6, 2014, the Company announced that it had signed a definitive agreement to sell the Industrial Packaging business to The Carlyle Group for \$3.2 billion. The transaction was completed on May 1, 2014, resulting in a pre-tax gain of \$1.7 billion (\$1.1 billion after-tax) in the second quarter of 2014 which was included in Income from discontinued operations.

Current Year Developments

Refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Distribution Methods

The Company's businesses primarily distribute their products directly to industrial manufacturers and through independent distributors.

Backlog

Backlog generally is not considered a significant factor in the Company's businesses as relatively short delivery periods and rapid inventory turnover are characteristic of most of their products. Backlog by segment as of December 31, 2018 and 2017 was as follows:

In millions	2018	2017
Automotive OEM	\$500	\$462
Food & Equipment	215	204
Test & Measurement and Electronics	378	342
Welding	93	90
Polymers & Fluids	67	57
Construction Products	30	39
Specialty Products	280	243
Total	\$1,563	\$1,437

Due to the predominately short term nature of the Company's arrangements with its customers, backlog orders scheduled for shipment beyond calendar year 2019 were not material as of December 31, 2018.

Competition

With operations in 55 countries, the Company offers a wide range of products in a myriad of markets, many of which are fragmented, and the Company encounters a variety of competitors that vary by product line, end market and geographic area. The Company's competitors include many regional or specialized companies, as well as large U.S. and non-U.S. companies or divisions of large companies. Each of the Company's segments generally has several main competitors and numerous smaller ones in most of their end markets and geographic areas. In addition to numerous smaller regional competitors, the Welding segment competes globally with Lincoln Electric and ESAB.

In virtually all segments, the Company differentiates its businesses from its competitors based on product innovation, product quality, brand preference and service delivery. Technical capability is also a competitive factor in most segments. The Company believes that each segment's primary competitive advantages derive from the Company's business model and decentralized operating structure, which creates a strong focus on end markets and customers at the local level, enabling its businesses to respond rapidly to market dynamics. This structure enables the Company's businesses to drive operational excellence utilizing the Company's 80/20 Front-to-Back process and leveraging its product innovation capabilities. The Company also believes that its global footprint is a competitive advantage in many of its markets, especially in its Automotive OEM segment.

Raw Materials

The Company uses raw materials of various types, primarily steel, resins and chemicals, that are available from numerous commercial sources. The availability of materials and energy has not resulted in any significant business interruptions or other major problems, and no such problems are currently anticipated.

Intellectual Property

The Company owns approximately 3,500 unexpired U.S. patents and 8,400 foreign patents covering articles, methods and machines. In addition, the Company has approximately 1,500 applications for patents pending in the U.S. Patent Office and 4,200 applications pending in foreign patent offices. There is no assurance that any of these patents will be issued. The Company maintains a patent group for the administration of patents and processing of patent applications.

7

The Company believes that many of its patents are valuable and important; however, the expiration of any one of the Company's patents would not have a material effect on the Company's results of operations or financial position. The Company also credits its success in the markets it serves to engineering capability; manufacturing techniques; skills and efficiency; marketing and sales promotion; and service and delivery of quality products to its customers.

In addition to patents, many of the Company's products and services are sold under various owned or licensed trademarks, which are important to the Company in the aggregate. Some of the Company's more significant trademarks include ITW, which is also used in conjunction with the trademarks of many of the Company's businesses; Deltar and Shakeproof in the Automotive OEM segment; Hobart in the Food Equipment segment; Instron in the Test & Measurement and Electronics segment; Miller in the Welding segment; Rain-X and Permatex in the Polymers & Fluids segment; Paslode in the Construction Products segment; and Hi-Cone in the Specialty Products segment.

Environmental

The Company believes that its manufacturing plants and equipment are in substantial compliance with all applicable environmental regulations. Additional measures to maintain compliance are not expected to materially affect the Company's capital expenditures, competitive position, financial position or results of operations.

Various legislative and administrative regulations concerning environmental issues have become effective or are under consideration in many parts of the world relating to manufacturing processes and the sale or use of certain products. To date, such developments have not had a substantial adverse impact on the Company's revenues, earnings or cash flows.

Employees

The Company employed approximately 48,000 people as of December 31, 2018 and considers its employee relations to be excellent.

Executive Officers

The executive officers of the Company serve at the discretion of the Board of Directors. Set forth below is information regarding the principal occupations and employment and business experience over the past five years for each executive officer. Unless otherwise stated, employment is by the Company.

Executive Officers of the Company as of February 15, 2019 were as follows: