

ILLINOIS TOOL WORKS INC

Form 10-Q

August 07, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

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

(State or other jurisdiction of incorporation or
organization)

36-1258310

(I.R.S. Employer Identification Number)

155 Harlem Avenue, Glenview, IL

(Address of principal executive offices)

60025

(Zip Code)

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

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files).

Yes ☒ No ☐

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

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company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ X

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

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

Yes ☐ []

No ☒ [X]

The number of shares of registrant’s common stock, \$0.01 par value, outstanding at June 30, 2015: 366,088,569.

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Part I – Financial Information

Item 1 – Financial Statements

Illinois Tool Works Inc. and Subsidiaries
Statement of Income (Unaudited)

In millions except per share amounts	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Operating Revenue	\$3,434	\$3,719	\$6,776	\$7,288
Cost of revenue	2,024	2,219	3,994	4,377
Selling, administrative, and research and development expenses	622	677	1,238	1,359
Amortization of intangible assets	58	60	117	122
Operating Income	730	763	1,427	1,430
Interest expense	(55)	(64)	(109)	(128)
Other income (expense)	21	7	42	16
Income from Continuing Operations Before Income Taxes	696	706	1,360	1,318
Income Taxes	216	212	422	396
Income from Continuing Operations	480	494	938	922
Income from Discontinued Operations	—	998	—	1,043
Net Income	\$480	\$1,492	\$938	\$1,965
Income Per Share from Continuing Operations:				
Basic	\$1.31	\$1.22	\$2.53	\$2.23
Diluted	\$1.30	\$1.21	\$2.51	\$2.22
Income Per Share from Discontinued Operations:				
Basic	\$—	\$2.47	\$—	\$2.52
Diluted	\$—	\$2.45	\$—	\$2.50
Net Income Per Share:				
Basic	\$1.31	\$3.69	\$2.53	\$4.76
Diluted	\$1.30	\$3.66	\$2.51	\$4.72
Cash Dividends Per Share:				
Paid	\$0.485	\$0.42	\$0.97	\$0.84
Declared	\$0.485	\$0.42	\$0.97	\$0.84
Shares of Common Stock Outstanding During the Period:				
Average	366.2	404.7	371.4	413.3
Average assuming dilution	368.4	407.6	373.8	416.3

The Notes to Financial Statements are an integral part of these statements.

Illinois Tool Works Inc. and Subsidiaries
Statement of Comprehensive Income (Unaudited)

In millions	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net Income	\$480	\$1,492	\$938	\$1,965
Other Comprehensive Income (Loss):				
Foreign currency translation adjustments, net of tax	169	(50	) (408	) (22
Pension and other postretirement benefit adjustments, net of tax	11	(11	) 20	(3
Comprehensive Income	\$660	\$1,431	\$550	\$1,940

The Notes to Financial Statements are an integral part of these statements.

Illinois Tool Works Inc. and Subsidiaries
Statement of Financial Position (Unaudited)

In millions	June 30, 2015	December 31, 2014
Assets		
Current Assets:		
Cash and equivalents	\$2,858	\$3,990
Trade receivables	2,412	2,293
Inventories	1,191	1,180
Deferred income taxes	185	212
Prepaid expenses and other current assets	387	401
Total current assets	7,033	8,076
Net plant and equipment	1,636	1,686
Goodwill	4,543	4,667
Intangible assets	1,679	1,799
Deferred income taxes	298	301
Other assets	1,159	1,149
	\$16,348	\$17,678
Liabilities and Stockholders' Equity		
Current Liabilities:		
Short-term debt	\$819	\$1,476
Accounts payable	533	512
Accrued expenses	1,147	1,287
Cash dividends payable	178	186
Income taxes payable	61	64
Deferred income taxes	8	8
Total current liabilities	2,746	3,533
Noncurrent Liabilities:		
Long-term debt	6,994	5,981
Deferred income taxes	363	338
Other liabilities	939	1,002
Total noncurrent liabilities	8,296	7,321
Stockholders' Equity:		
Common stock	6	6
Additional paid-in-capital	1,113	1,096
Income reinvested in the business	17,755	17,173
Common stock held in treasury	(12,526)	(10,798)
Accumulated other comprehensive income	(1,046)	(658)
Noncontrolling interest	4	5
Total stockholders' equity	5,306	6,824
	\$16,348	\$17,678

The Notes to Financial Statements are an integral part of these statements.

Illinois Tool Works Inc. and Subsidiaries
Statement of Cash Flows (Unaudited)

In millions	Six Months Ended June 30,		
	2015	2014	
Cash Provided by (Used for) Operating Activities:			
Net income	\$938	\$1,965	
Adjustments to reconcile net income to cash provided by (used for) operating activities:			
Depreciation	119	137	
Amortization and impairment of goodwill and other intangible assets	117	122	
Change in deferred income taxes	(7	) 51	
Provision for uncollectible accounts	4	5	
(Income) loss from investments	3	(6)
(Gain) loss on sale of plant and equipment	(1) —	
(Gain) loss on discontinued operations	—	(1,709)
(Gain) loss on sale of operations and affiliates	(16	) 5	
Stock-based compensation expense	24	21	
Other non-cash items, net	5	4	
Change in assets and liabilities, net of acquisitions and divestitures:			
(Increase) decrease in-			
Trade receivables	(189	) (232)
Inventories	(48	) (55)
Prepaid expenses and other assets	26	(71)
Increase (decrease) in-			
Accounts payable	40	(22)
Accrued expenses and other liabilities	(116	) (1)
Income taxes	(9	) 746	
Other, net	—	(73)
Net cash provided by (used for) operating activities	890	887	
Cash Provided by (Used for) Investing Activities:			
Acquisition of businesses (excluding cash and equivalents) and additional interest in affiliates	(6	) (6)
Additions to plant and equipment	(147	) (146)
Proceeds from investments	3	11	
Proceeds from sale of plant and equipment	12	15	
Net proceeds from sales of discontinued operations	—	3,177	
Proceeds from sales of operations and affiliates	29	9	
Other, net	(52	) 14	
Net cash provided by (used for) investing activities	(161	) 3,074	
Cash Provided by (Used for) Financing Activities:			
Cash dividends paid	(365	) (355)
Issuance of common stock	47	81	
Repurchases of common stock	(1,786	) (2,905)
Net proceeds from (repayments of) debt with original maturities of three months or less	(656	) (1,680)
Proceeds from debt with original maturities of more than three months	1,098	3,329	
Repayments of debt with original maturities of more than three months	—	(801)

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Excess tax benefits from stock-based compensation	16	19	
Other, net	(13) (12)
Net cash provided by (used for) financing activities	(1,659) (2,324)
Effect of Exchange Rate Changes on Cash and Equivalents	(202	) 42	
Cash and Equivalents:			
Increase (decrease) during the period	(1,132	) 1,679	
Beginning of period	3,990	3,618	
End of period	\$2,858	\$5,297	
Supplementary Cash and Non-Cash Information:			
Cash Paid During the Period for Interest	\$113	\$93	
Cash Paid During the Period for Income Taxes, Net of Refunds	\$390	\$343	
The Notes to Financial Statements are an integral part of these statements.			

Illinois Tool Works Inc. and Subsidiaries
Notes to Financial Statements (Unaudited)

(1) Financial Statements

The unaudited financial statements included herein have been prepared by Illinois Tool Works Inc. and Subsidiaries (the “Company”). In the opinion of management, the interim financial statements reflect all adjustments of a normal recurring nature necessary for a fair statement of the results for interim periods. It is suggested that these financial statements be read in conjunction with the financial statements and notes to financial statements included in the Company’s 2014 Annual Report on Form 10-K. Certain reclassifications of prior year data have been made to conform with current year reporting.

(2) Discontinued Operations

The Company periodically reviews its operations for businesses that may no longer be aligned with its enterprise initiatives and long-term objectives. As a result, the Company may commit to a plan to exit or dispose of certain businesses and present them as discontinued operations. The following summarizes the Company’s discontinued operations.

Third Quarter 2013 Discontinued Operations - In the third quarter of 2013, the Company committed to a plan to sell the Industrial Packaging business and began classifying this business as held for sale. The Industrial Packaging business was sold in the second quarter of 2014.

In the third quarter of 2013, the Company also committed to a plan for the divestiture of a construction business previously included in the Construction Products segment. This business was classified as held for sale beginning in the third quarter of 2013 and was sold in the second quarter of 2014.

First Quarter 2013 Discontinued Operations - In the first quarter of 2013, the Company committed to a plan for the divestiture of a construction distribution business previously included in the Construction Products segment. This business was classified as held for sale beginning in the first quarter of 2013 and was sold in the second quarter of 2014.

As of the second quarter of 2014, the Company had completed the divestiture of all of the businesses previously reported as discontinued operations.

Results of the discontinued operations for the three and six months ended June 30, 2014 were as follows:

In millions	Three Months Ended June 30, 2014	Six Months Ended June 30, 2014
Operating revenue	\$212	\$798
Income before income taxes	\$1,724	\$1,796
Income tax expense	(726)	(753)
Income from discontinued operations	\$998	\$1,043

Income before income taxes from discontinued operations was income of \$1.8 billion for the six months ended June 30, 2014. The income in the first six months of 2014 included the pre-tax gain of \$1.7 billion (\$1.1 billion after tax) on the sale of the Industrial Packaging business recorded in the second quarter of 2014. Income tax expense in the first

six months of 2014 included \$175 million of U.S. income tax expense related to the repatriation of approximately \$1.3 billion of international proceeds from the sale of the Industrial Packaging business.

In April 2014, the Financial Accounting Standards Board ("FASB") issued authoritative guidance to change the criteria for reporting discontinued operations. Under the new guidance, only disposals representing a strategic shift in a company's operations and financial results should be reported as discontinued operations, with expanded disclosures. In addition, disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify as a discontinued operation is required. The Company adopted this new guidance effective January 1, 2015. The new guidance applies prospectively to new disposals and new classifications of disposal groups held for sale after such date. As a result, this guidance did not have any impact on the Company's financial statements or related disclosures upon adoption.

(3) Income Taxes

The Company files tax returns in the U.S. and various state, local and foreign jurisdictions. These tax returns are routinely audited by the tax authorities in these jurisdictions including the Internal Revenue Service ("IRS"), Her Majesty's Revenue and Customs, German Fiscal Authority, French Fiscal Authority, and Australian Tax Office, and a number of these audits are currently ongoing, which may increase the amount of the unrecognized tax benefits in future periods. The Company believes it is reasonably possible that within the next twelve months the amount of the Company's unrecognized tax benefits may be decreased by approximately \$54 million related predominantly to various intercompany transactions. The Company has recorded its best estimate of the potential exposure for these issues.

On February 18, 2014, the Company received a Notice of Deficiency ("NOD") from the IRS asserting that a non-taxable return of capital received from a subsidiary was a taxable dividend distribution. The NOD assesses additional taxes of \$70 million for the 2006 tax year, plus interest and penalties. In May 2014, the Company petitioned the United States Tax Court to challenge the NOD. The Company's petition was subsequently denied and the case will proceed to court. Although the outcome of this process cannot be predicted with certainty, the Company believes it will be successful in defending its positions. Accordingly, no reserve has been recorded related to this matter.

(4) Inventories

Inventories as of June 30, 2015 and December 31, 2014 were as follows:

In millions	June 30, 2015	December 31, 2014
Raw material	\$454	\$458
Work-in-process	142	133
Finished goods	683	677
LIFO reserve	(88)	(88)
Total inventories	\$1,191	\$1,180

(5) Pension and Other Postretirement Benefits

Pension and other postretirement benefit costs related to both continuing and discontinued operations for the three and six months ended June 30, 2015 and 2014, were as follows:

In millions	Three Months Ended June 30,				Six Months Ended June 30,			
	Pension		Other Postretirement Benefits		Pension		Other Postretirement Benefits	
	2015	2014	2015	2014	2015	2014	2015	2014
Components of net periodic benefit cost:								
Service cost	\$18	\$20	\$2	\$2	\$36	\$40	\$5	\$5
Interest cost	23	26	6	6	46	52	12	12
Expected return on plan assets	(38)	(39)	(6)	(6)	(76)	(79)	(12)	(12)
Amortization of actuarial (gain) loss	15	12	—	(1)	30	24	—	(3)
Settlement/curtailment (gain) loss	—	2	—	(9)	—	2	—	(9)
Net periodic benefit (income) cost	\$18	\$21	\$2	\$(8)	\$36	\$39	\$5	\$(7)
Amounts were included in the statement of income as follows:								
Continuing operations	\$18	\$18	\$2	\$1	\$36	\$34	\$5	\$2
Discontinued operations	—	3	—	(9)	—	5	—	(9)

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Net periodic benefit (income) cost	\$18	\$21	\$2	\$(8)	\$36	\$39	\$5	\$(7)
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The Company expects to contribute approximately \$100 million to its pension plans and \$5 million to its other postretirement plans in 2015. As of June 30, 2015, contributions of \$89 million to pension plans and \$3 million to other postretirement plans have been made.

(6) Debt

Short-term debt as of June 30, 2015 and December 31, 2014 included commercial paper of \$805 million and \$1.4 billion, respectively.

In May 2015, the Company issued €500 million of 1.25% Euro notes due May 22, 2023 at 99.239% of face value and €500 million of 2.125% Euro notes due May 22, 2030 at 99.303% of face value. Net proceeds from the May 2015 debt issuances were used to repay commercial paper and for general corporate purposes. The Company designated the €1.0 billion of Euro notes as a hedge of a portion of its net investment in Euro-denominated foreign operations to reduce foreign currency risk associated with the investment in these operations. Changes in the value of this debt resulting from fluctuations in the Euro to U.S. Dollar exchange rate have been recorded as foreign currency translation adjustments within Accumulated other comprehensive income. Refer to the Accumulated other comprehensive income note for additional information regarding the net investment hedge.

The approximate fair value and related carrying value of the Company's total long-term debt, including current maturities of long-term debt presented as short-term debt, as of June 30, 2015 and December 31, 2014 were as follows:

In millions	June 30, 2015	December 31, 2014
Fair value	\$7,131	\$6,431
Carrying value	6,995	5,982

The approximate fair values of the Company's long-term debt, including current maturities, were based on a Level 2 valuation model, using observable inputs which included market rates for comparable instruments for the respective periods.

(7) Accumulated Other Comprehensive Income

The following table summarizes changes in Accumulated other comprehensive income for the three and six months ended June 30, 2015 and 2014:

In millions	Three Months Ended June 30,	Six Months Ended
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