

Illinois Tool Works

3Q23 review: end markets are a headwind, solid margin execution

Reiterate Rating: NEUTRAL | PO: 260.00 USD | Price: 223.06 USD

3Q23 GAAP EPS comes in above Street on corporate

ITW reported GAAP EPS that came in \$0.10 above our model. This was driven by a one-time insurance recovery in corporate and FX tailwinds. Core ops were a slight miss. While margins were broadly in line with our model, organic growth came in light relative to our estimates on destocking and incremental slowdown in residential and electronics end markets. The company also highlighted the impact of the UAW strike in 4Q23. While demand has likely bottomed in consumer electronics/Asia semis, expected 2H23 recovery has been pushed out. The company seems to finally be feeling the impact of higher rates on its resi construction businesses. We think the impact of higher rates and a weaker consumer will pressure ITW in 4Q23 and into 2024. At the same time, ITW appears confident in its ability to continue to deliver margin expansion and its long-term targets for 35-40% incrementals in 2024 and beyond. Reiterate Neutral.

Lowering growth, margin intact for both 4Q & 2024

The demand picture for ITW remains mixed into '24. Consumer electronics remains weak, semiconductor recovery seems to have been pushed out, and activity in profitable residential construction businesses (both Construction Products and Welding) has slowed. We still have confidence in the company's ability to deliver margin next year on Enterprise Initiatives, which we model benefitting Test & Measurement & Electronics and Welding in particular. We note that Polymers & Fluids and Construction Products have benefitted disproportionately this year & run-rate the benefits from 3Q into 4Q.

UAW strike: not concerned about '24/'25 margin ramp yet

We do not think the UAW strike impacts ITW's ability to ramp margins in 2024/2025. Volume leverage is the key to expanding margins, and 4Q23 will face headwinds from the strike (we estimate 4.3% impact from revenue and 28bp from margin). We slightly lower our 2024 margin estimate to account for spillover impact from the strike but maintain our 2025 estimate.

Narrowing GAAP EPS, guide assumes \$0.12 UAW impact

ITW narrowed 2023 GAAP EPS by \$0.10 on each end to \$9.65-\$9.85. The one-time benefit from corporate in 3Q23 is offset by \$0.12 headwind from UAW. Guidance assumes the UAW strike lasts the whole Q and includes some deterioration of the strike.

| Estimates (Dec) (US\$) | 2021A | 2022A | 2023E | 2024E | 2025E |
|---------------------------|-------|-------|-------|-------|-------|
| EPS | 8.51 | 9.77 | 9.75 | 10.03 | 10.96 |
| EPS Change (YoY) | 28.4% | 14.8% | -0.2% | 2.9% | 9.3% |
| Consensus EPS (Bloomberg) | | | 9.74 | 10.27 | 11.05 |
| DPS | 4.72 | 5.06 | 5.42 | 5.80 | 6.04 |
| Valuation (Dec) | | | | | |
| P/E | 26.2x | 22.8x | 22.9x | 22.2x | 20.4x |
| GAAP P/E | 26.2x | 22.8x | 22.9x | 22.2x | 20.4x |
| Dividend Yield | 2.1% | 2.3% | 2.4% | 2.6% | 2.7% |
| EV / EBITDA* | 19.5x | 18.1x | 17.0x | 16.5x | 15.5x |
| Free Cash Flow Yield* | 3.4% | 2.9% | 4.6% | 4.7% | 5.0% |

* For full definitions of *IQmethod*SM measures, see page 13.

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Timestamp: 24 October 2023 06:41PM EDT

24 October 2023

Equity

Key Changes

| (US\$) | Previous | Current |
|---------------|----------|----------|
| 2023E Rev (m) | 16,244.6 | 16,117.0 |
| 2024E Rev (m) | 16,969.0 | 16,684.2 |
| 2025E Rev (m) | 17,549.6 | 17,372.5 |
| 2023E EPS | 9.72 | 9.75 |
| 2024E EPS | 10.04 | 10.03 |

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Stock Data

| | |
|---------------------------------|-------------------------|
| Price | 223.06 USD |
| Price Objective | 260.00 USD |
| Date Established | 3-Feb-2023 |
| Investment Opinion | B-2-7 |
| 52-Week Range | 196.76 USD - 264.19 USD |
| Mrkt Val (mn) / Shares Out (mn) | 67,116 USD / 300.9 |
| Average Daily Value (mn) | 239.98 USD |
| BofA Ticker / Exchange | ITW / NYS |
| Bloomberg / Reuters | ITW US / ITW.N |
| ROE (2023E) | 98.8% |
| Net Dbt to Eqty (Dec-2022A) | 228.4% |
| ESGMeter™ | High |

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

iQprofileSM Illinois Tool Works

iQmethodSM – Bus Performance*

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|----------------------------|-------|-------|-------|-------|-------|
| Return on Capital Employed | 21.1% | 23.3% | 25.0% | 25.1% | 26.5% |
| Return on Equity | 79.1% | 90.4% | 98.8% | 98.8% | 96.4% |
| Operating Margin | 24.1% | 23.8% | 25.1% | 25.1% | 25.7% |
| Free Cash Flow | 2,261 | 1,936 | 3,084 | 3,164 | 3,336 |

iQmethodSM – Quality of Earnings*

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|--------------------------|--------|--------|--------|--------|--------|
| Cash Realization Ratio | 0.9x | 0.8x | 1.2x | 1.2x | 1.1x |
| Asset Replacement Ratio | 0.7x | 1.0x | 0.8x | 0.8x | 0.8x |
| Tax Rate | 19.0% | 21.0% | 23.0% | 24.0% | 24.0% |
| Net Debt-to-Equity Ratio | 169.9% | 228.4% | 245.3% | 210.2% | 176.4% |
| Interest Cover | 17.2x | 18.7x | 15.5x | 14.6x | 17.0x |

Income Statement Data (Dec)

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|------------------------------|--------------|--------------|--------------|--------------|--------------|
| Sales | 14,455 | 15,936 | 16,117 | 16,684 | 17,373 |
| % Change | 15.0% | 10.2% | 1.1% | 3.5% | 4.1% |
| Gross Profit | 5,966 | 6,507 | 6,802 | 7,007 | 7,296 |
| % Change | 14.8% | 9.1% | 4.5% | 3.0% | 4.1% |
| EBITDA | 3,887 | 4,200 | 4,467 | 4,605 | 4,890 |
| % Change | 17.5% | 8.1% | 6.4% | 3.1% | 6.2% |
| Net Interest & Other Income | (151) | 52 | (211) | (236) | (212) |
| Net Income (Adjusted) | 2,694 | 3,034 | 2,959 | 3,003 | 3,234 |
| % Change | 27.7% | 12.6% | -2.5% | 1.5% | 7.7% |

Free Cash Flow Data (Dec)

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|--|---------------|---------------|--------------|--------------|--------------|
| Net Income from Cont Operations (GAAP) | 2,694 | 3,034 | 2,959 | 3,003 | 3,234 |
| Depreciation & Amortization | 410 | 410 | 414 | 418 | 422 |
| Change in Working Capital | (439) | (818) | (138) | 104 | 49 |
| Deferred Taxation Charge | NA | NA | NA | NA | NA |
| Other Adjustments, Net | (108) | (278) | 171 | (27) | (22) |
| Capital Expenditure | (296) | (412) | (322) | (334) | (347) |
| Free Cash Flow | 2,261 | 1,936 | 3,084 | 3,164 | 3,336 |
| % Change | -12.1% | -14.4% | 59.3% | 2.6% | 5.4% |

Balance Sheet Data (Dec)

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash & Equivalents | 1,527 | 708 | 1,122 | 1,219 | 1,673 |
| Trade Receivables | 2,840 | 3,171 | 3,251 | 3,228 | 3,219 |
| Other Current Assets | 2,007 | 2,391 | 2,409 | 2,384 | 2,441 |
| Property, Plant & Equipment | 1,809 | 1,848 | 1,892 | 1,944 | 2,007 |
| Other Non-Current Assets | 7,894 | 7,304 | 7,169 | 7,032 | 6,894 |
| Total Assets | 16,077 | 15,422 | 15,842 | 15,807 | 16,234 |
| Short-Term Debt | 778 | 1,590 | 0 | 0 | 0 |
| Other Current Liabilities | 2,692 | 3,143 | 3,103 | 3,159 | 3,256 |
| Long-Term Debt | 6,909 | 6,173 | 8,239 | 7,899 | 7,899 |
| Other Non-Current Liabilities | 2,072 | 1,427 | 1,598 | 1,571 | 1,549 |
| Total Liabilities | 12,451 | 12,333 | 12,941 | 12,629 | 12,704 |
| Total Equity | 3,626 | 3,089 | 2,902 | 3,177 | 3,530 |
| Total Equity & Liabilities | 16,077 | 15,422 | 15,842 | 15,807 | 16,234 |

* For full definitions of iQmethodSM measures, see page 13.

Company Sector

Industrials/Multi-Industry

Company Description

ITW is a highly diversified industrial conglomerate that designs and manufactures fasteners, components, equipment, consumables, and a variety of specialty products and equipment for a broad array of industries. Across its seven segments, Auto OE accounts for 19% of sales, Food Equipment 14%, Test & Measurement 16%, Welding 11%, Polymers & Fluids 13%, Construction Products 14%, and Specialty Products 13%. By region, North America accounts for about 52% of sales, EMEA 27%, APAC 19%, and SA 2%.

Investment Rationale

ITW is a large cap industrial conglomerate that has best in class margins and returns. Through the cycle, ITW generally grows in line with GDP while its 80-20 business model is designed for continuous margin and ROIC improvement. We think the stock performs broadly in line with the market as structural margin expansion in the coming years is offset by the near-term risk of cyclical downturn.

Stock Data

Average Daily Volume 1,075,858

Quarterly Earnings Estimates

| | 2022 | 2023 |
|----|-------|-------|
| Q1 | 2.11A | 2.33A |
| Q2 | 2.37A | 2.48A |
| Q3 | 2.35A | 2.55A |
| Q4 | 2.95A | 2.39E |

Exhibit 1: 3Q23 earnings variance analysis

Actual versus estimate

| | Actual | Reported | | BofA Estimate | | Variation Versus BofA Est. | | |
|---|---------------|---------------|---------------|---------------|--------------|----------------------------|--------------|------------------|
| (in US\$ mn, except per share data) | 3Q:22A | 3Q:23A | y/y% chg. | 3Q:23E | y/y% chg. | Dollar | Percentage | EPS |
| Segment Sales | | | | | | | | |
| Automotive OEM | 753 | 799 | 6% | 814 | 8% | (15) | -2% | |
| Food Equipment | 633 | 678 | 7% | 672 | 6% | 6 | 1% | |
| Test & Measurement & Electronics | 715 | 698 | -2% | 707 | -1% | (9) | -1% | |
| Welding | 477 | 468 | -2% | 499 | 5% | (31) | -6% | |
| Polymers & Fluids | 473 | 458 | -3% | 465 | -2% | (7) | -1% | |
| Construction Products | 527 | 522 | -1% | 507 | -4% | 15 | 3% | |
| Specialty Products | 438 | 414 | -5% | 426 | -3% | (12) | -3% | |
| Industrial Packaging | - | - | 0% | - | - | - | - | |
| Intersegment | (5) | (6) | 20% | (6) | 20% | - | - | |
| Total | 4,011 | 4,031 | 0% | 4,084 | 2% | (53) | -1% | |
| Segment Operating Profit | | | | | | | | |
| Automotive OEM | 132 | 151 | 14% | 143 | 8% | 8 | 6% | \$ 0.02 |
| Food Equipment | 167 | 185 | 11% | 191 | 15% | (6) | -3% | \$ (0.02) |
| Test & Measurement & Electronics | 180 | 167 | -7% | 182 | 1% | (15) | -8% | \$ (0.04) |
| Welding | 150 | 147 | -2% | 167 | 11% | (20) | -12% | \$ (0.05) |
| Polymers & Fluids | 119 | 129 | 8% | 117 | -1% | 12 | 10% | \$ 0.03 |
| Construction Products | 136 | 155 | 14% | 146 | 7% | 9 | 6% | \$ 0.02 |
| Specialty Products | 121 | 115 | -5% | 111 | -8% | 4 | 3% | \$ 0.01 |
| Segment Total | 1,005 | 1,049 | 4% | 1,058 | 5% | (9) | -1% | \$ (0.02) |
| Unallocated | (22) | 21 | -195% | (30) | 36% | 51 | -170% | \$ 0.13 |
| Total | 983 | 1,070 | 9% | 1,028 | 5% | 42 | 4% | \$ 0.11 |
| Segment Operating Margin | | | | | | | | |
| Automotive OEM | 17.5% | 18.9% | 140 bp | 17.6% | 0 bp | | 130 bp | |
| Food Equipment | 26.4% | 27.3% | 90 bp | 28.5% | 210 bp | | (120 bp) | |
| Test & Measurement & Electronics | 25.2% | 23.9% | (120 bp) | 25.7% | 50 bp | | (170 bp) | |
| Welding | 31.4% | 31.4% | 0 bp | 33.4% | 200 bp | | (200 bp) | |
| Polymers & Fluids | 25.2% | 28.2% | 300 bp | 25.3% | 10 bp | | 290 bp | |
| Construction Products | 25.8% | 29.7% | 390 bp | 28.8% | 300 bp | | 90 bp | |
| Specialty Products | 27.6% | 27.8% | 20 bp | 26.1% | (150 bp) | | 170 bp | |
| Segment Total | 25.1% | 26.0% | 100 bp | 25.9% | 80 bp | | 10 bp | |
| Net Sales | 4,011 | 4,031 | 0% | 4,084 | 2% | (53) | -1% | |
| COGS | 2,371 | 2,319 | -2% | 2,389 | 1% | (70) | -3% | |
| Gross Profit | 1,640 | 1,712 | 4% | 1,695 | 3% | 17 | 1% | \$ 0.04 |
| SG&A | 657 | 642 | -2% | 667 | 2% | (25) | -4% | \$ 0.06 |
| Operating Income | 983 | 1,070 | 9% | 1,028 | 5% | 42 | 4% | \$ 0.11 |
| Interest expense / (income) | (52) | (67) | NM | (68) | NM | 1 | -2% | \$ 0.00 |
| Other income | 26 | 10 | -62% | 15 | -42% | (5) | -33% | \$ (0.01) |
| EBT | 957 | 1,013 | 6% | 975 | 2% | 38 | 4% | \$ 0.10 |
| Taxes | 230 | 241 | 5% | 234 | 2% | 7 | 3% | |
| Tax Rate | 24.0% | 23.8% | (20 bp) | 24.0% | 0 bp | | (20 bp) | \$ 0.01 |
| Net Income (Continuing Operations) | 727 | 772 | 6% | 741 | 2% | 31 | 4% | \$ 0.10 |
| Discontinued Operations | - | - | NM | - | NM | - | NM | |
| Net Income (GAAP) | 727 | 772 | 6% | 741 | 2% | 31 | 4% | |
| FULLY DILUTED EPS | \$2.35 | \$2.55 | 9% | \$2.45 | 4% | \$0.10 | 4% | \$ - |
| Diluted Shares Outstanding | 310 | 303 | -2% | 303 | -2% | - | 0% | \$ - |

| | Actual | Reported | | BofA Estimate | | Variation (b.p.) | |
|----------------------------|--------|----------|--|---------------|--|------------------|----------|
| Margin Analysis | 3Q:22A | 3Q:23A | | 3Q:23E | | BofA Est. | 3Q:22A |
| COGS | 59.1% | 57.5% | | 58.5% | | (100 bp) | (160 bp) |
| Gross Margin | 40.9% | 42.5% | | 41.5% | | 100 bp | 160 bp |
| SG&A | 16.4% | 15.9% | | 16.3% | | (40 bp) | (50 bp) |
| Operating Margin | 24.5% | 26.5% | | 25.2% | | 140 bp | 200 bp |
| EBT Margin | 23.9% | 25.1% | | 23.9% | | 130 bp | 130 bp |
| Net Margin | 18.1% | 19.2% | | 18.1% | | 100 bp | 100 bp |
| Segment Incremental Margin | 25.7% | 220.0% | | 72.6% | | 14740 bp | 19430 bp |

Source: BofA Global Research

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Slightly raise '23 GAAP EPS to midpoint

ITW narrowed 2023 GAAP EPS guidance to \$9.65-\$9.85, by \$0.10 on each end. This reflects the corporate benefit in 3Q23 and \$0.12 impact from the UAW strike. The midpoint of the guidance is the same. ITW is being conservative on the impact of the strike and assumes it lasts for the whole quarter. Our estimates incorporate 6 weeks of the strike. The company raised the low end of its segment margin guide by 50bps to 25.0%-25.5%. Organic growth guide is for +2-3% y/y vs. +3-5% prior. The impact of destocking is 1.0-1.5% y/y, as cited in prior guidance. The company is forecasting divestitures and foreign exchange to have a combined impact of (1)%.

We forecast total operating margins of 25.1% for 2023, up 110bps y/y. Our segment total estimate is unchanged at 25.4%. The total number is lower given the impact of one-time corporate benefits (insurance recovery) in 3Q. While we lower our growth estimates, we maintain our margin estimate because we are confident in the company's ability to continue delivering on margin.

We lower our 4Q23 estimate to \$2.39 (by \$0.08). We are maintaining our Auto estimate as we had previously forecasted the impact of the strike. We lower our estimates mostly in Welding and Test & Measurement & Electronics to reflect incremental demand softening and unlikely recovery until sometime next year.

Exhibit 2: ITW 2023 outlook vs. BofA estimates and Bloomberg consensus

BofA GAAP EPS raised to \$9.75

| As of | FY23 outlook | | | | BofA | | Consensus |
|--------------------------|------------------------|------------------------|------------------------|------------------------|-----------------|-----------------|-----------------|
| | 4Q22 | 1Q23 | 2Q23 | 3Q23 | Old | New | |
| Organic Sales Growth | 3-5% | 3-5% | 3-5% | 2-3% | 2.7% | 1.7% | 3.2% |
| FX | -0.8% | -0.5% | -0.5% | -0.5% | -0.1% | 0.2% | -0.6% |
| M&A | -0.8% | -0.5% | -0.5% | -0.5% | -0.7% | -0.9% | -0.2% |
| Total Sales Growth | 2.5% | 2-4% | 2-4% | 1-2% | 1.9% | 1.1% | 2.5% |
| Sales | \$16.2-\$16.5bn | \$16.3-\$16.6bn | \$16.3-\$16.6bn | \$16.1-\$16.4bn | \$16.2bn | \$16.1bn | \$16.3bn |
| Segment Operating margin | 24.5%-25.5% | 24.5%-25.5% | 24.5%-25.5% | 24.5%-25.5% | 24.9% | 25.1% | 24.9% |
| Tax Rate | ~24% | 23.5%-24.0% | 22.5-23.5% | 22.5-23.5% | 23.0% | 23.0% | 23.1% |
| GAAP EPS | \$9.40-\$9.80 | \$9.45-\$9.85 | \$9.55-\$9.95 | \$9.65-\$9.85 | \$9.72 | \$9.75 | \$9.75 |
| FCF conversion | >100% | >100% | >100% | >100% | 104% | 104% | |

Source: BofA Global Research, Visible Alpha, Bloomberg

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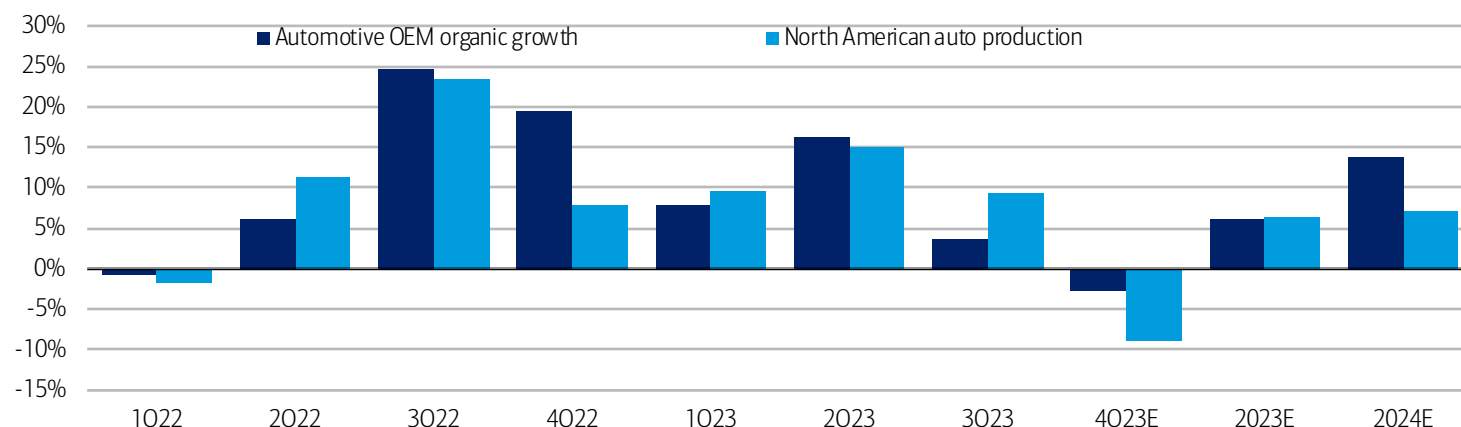
UAW strike delaying Auto margin recovery

At its May 2023 investor day, ITW committed to return to low-mid 20's operating margin in 2026. We view this path as believable, but already incorporated into our view of the company. The path from 2022A margins of 16.8% to the new target is for 1-2% benefit of price/cost, 2% benefit from better volume leverage on higher build rates, 1% benefit from higher margin CBI, and 1-2% benefit from Enterprise Initiatives.

Automotive OEM (~20% of sales) topline is correlated tightly with auto production volumes (96% correlation to global, 88% correlation to US). We forecast +6.2% organic growth in 2023E (with the strike a ~140bps drag in our model). We forecast 17.2% operating margin, yielding 23% incremental margins. Given accelerating 2024E auto production volumes, we forecast accelerating organic growth in 2024E.

Exhibit 3: Automotive OEM topline is correlated with Auto production volumes

We forecast +14% organic growth in 2023, which compares to the Automotive Research forecast for +7% y/y growth



Source: BofA Automotive Research, BofA Global Research estimates

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Margins at the Automotive OEM segment have lagged the rest of ITW in recent years after global auto production volumes peaked in 2018. Other segment margins have steadily expanded in the same timeframe. In 2022, this segment represented 19% of ITW's revenue but only 13% of segment EBIT.

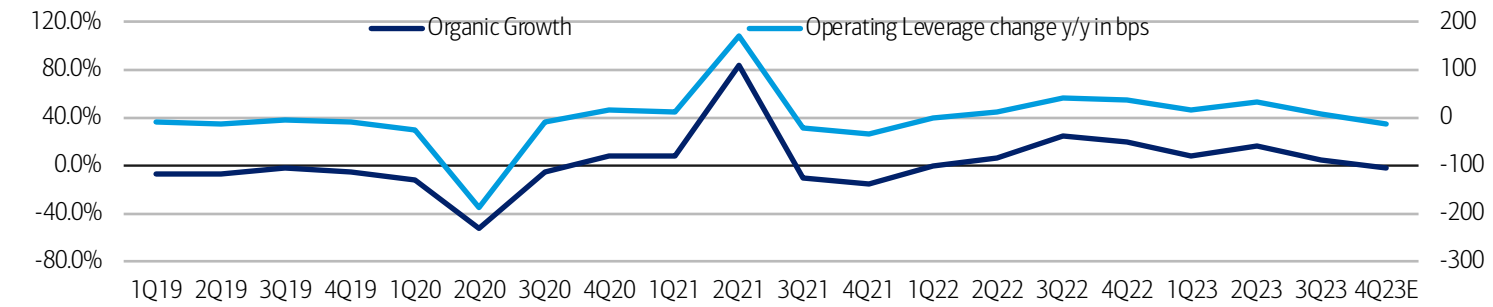
3Q23 Auto OEM margins were up 210bps sequentially and the company delivered 41% incrementals on +3.8% organic growth. In our view, this represents a step in the right direction for the segment; however, the impact of the UAW strike will drag 4Q margins. We see better recovery prospects in 2024E, even if the company is not able to recover all the lost revenue from the strike.

What's in our model: addressing strike estimates

ITW is prudently assuming that the strike lasts the full quarter. We model that the strike ends in mid-November. This translates to ~\$(32)mn of lost revenue and (28)bp of incremental margin pressure, netting an \$0.08 impact to EPS. Our estimate is not materially changed from our prior estimate (\$0.06 impact) but the revenue lost per month is lower (now modeling \$20mn/month), and we assume the strike lasts for longer.

We estimate that the company has very little pricing in its Auto OEM segment given industry structure and large exposure to the Big 3 (estimate ~30% of the segment). As a result, the segment has very little variation in topline vs. operating leverage, and the two move in a tight band. We forecast (13)bp y/y headwind from operating leverage in our margin bridge (vs. a 15bp benefit without the strike).

Exhibit 4: Automotive OEM organic growth vs. operating leverage y/y
There is a 97% correlation between organic growth and operating leverage



Source: BofA Global Research estimates

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Exhibit 5: Segment margin analysis

Welding has typically displayed the strongest margins in the last couple of years

| | 2020 | | | | 2021 | | | | 2022 | | | | 2023 E | | | |
|----------------------------------|--------------|--------------|--------------|---------------|--------------|--------------|--------------|--------------|---------------|----------------|--------------|--------------|---------------|---------------|---------------|---------------|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q |
| Automotive OEM | 20.8% | -7.8% | 20.9% | 23.9% | 24.1% | 18.8% | 17.3% | 16.7% | 18.2% | 14.2% | 17.5% | 17.2% | 16.1% | 16.8% | 18.9% | 17.1% |
| Food Equipment | 24.2% | 9.2% | 19.6% | 22.5% | 21.3% | 22.0% | 23.9% | 22.8% | 22.3% | 24.8% | 26.4% | 27.4% | 26.6% | 27.8% | 27.3% | 28.3% |
| Test & Measurement & Electronics | 24.9% | 25.7% | 23.7% | 28.7% | 28.4% | 28.1% | 26.8% | 26.4% | 21.8% | 22.6% | 25.2% | 27.0% | 24.5% | 23.1% | 23.9% | 25.2% |
| Welding | 29.3% | 21.5% | 27.7% | 29.1% | 30.2% | 28.6% | 30.1% | 29.9% | 30.9% | 29.2% | 31.4% | 31.6% | 31.8% | 34.1% | 31.4% | 31.7% |
| Polymers & Fluids | 23.7% | 23.2% | 26.5% | 25.4% | 25.7% | 27.3% | 24.3% | 23.9% | 24.5% | 25.2% | 25.2% | 25.7% | 24.4% | 25.9% | 28.2% | 28.2% |
| Construction Products | 23.3% | 23.9% | 28.1% | 26.0% | 27.7% | 27.6% | 27.8% | 25.8% | 24.7% | 27.6% | 25.8% | 25.5% | 27.6% | 29.3% | 29.7% | 29.0% |
| Specialty Products | 26.3% | 25.3% | 25.2% | 27.1% | 27.6% | 27.2% | 27.5% | 26.6% | 26.3% | 27.1% | 27.6% | 25.8% | 25.8% | 25.8% | 27.8% | 25.8% |
| TOTAL operating income | 23.6% | 17.5% | 23.9% | 25.4% | 25.5% | 24.3% | 23.8% | 22.7% | 22.7% | 23.1% | 24.5% | 24.8% | 24.1% | 24.8% | 26.5% | 25.1% |
| Incremental margins | | | | | | | | | | | | | | | | |
| Automotive OEM | 20.0% | 47.3% | 50.0% | 49.3% | 50.6% | 46.5% | 55.2% | 58.4% | 221.7% | -800.0% | 18.9% | 20.7% | -27.8% | 33.0% | 41.3% | -1.3% |
| Food Equipment | 34.3% | 51.4% | 62.7% | 51.0% | 65.6% | 46.1% | 44.2% | 24.5% | 26.1% | 39.0% | 41.6% | 69.4% | 62.3% | 75.0% | 40.0% | 39.4% |
| Test & Measurement & Electronics | 12.8% | 17.9% | 60.9% | 11.1% | 53.7% | 35.1% | 50.8% | 14.7% | -6.0% | -14.4% | 19.6% | 31.3% | 127.8% | 125.0% | 76.5% | -136.8% |
| Welding | 20.0% | 46.8% | 30.4% | -47.4% | 41.4% | 49.0% | 40.5% | 35.2% | 36.7% | 32.1% | 42.3% | 44.1% | 41.9% | 625.0% | 33.3% | 28.4% |
| Polymers & Fluids | -17.4% | 20.5% | 75.0% | 58.6% | 45.2% | 40.2% | -27.8% | -40.0% | 13.0% | -6.7% | 47.1% | 125.0% | 26.5% | 16.2% | -66.7% | 109.6% |
| Construction Products | -36.4% | 33.3% | 57.5% | 58.7% | 49.4% | 37.3% | 22.7% | 24.0% | 7.3% | 27.7% | 6.1% | 40.0% | -36.0% | 5.1% | -380.0% | -130.8% |
| TOTAL | 17.3% | 42.1% | 47.7% | 783.3% | 46.2% | 42.7% | 35.7% | -4.4% | -1.3% | 7.5% | 25.7% | 40.1% | 75.0% | 123.8% | 220.0% | 157.7% |

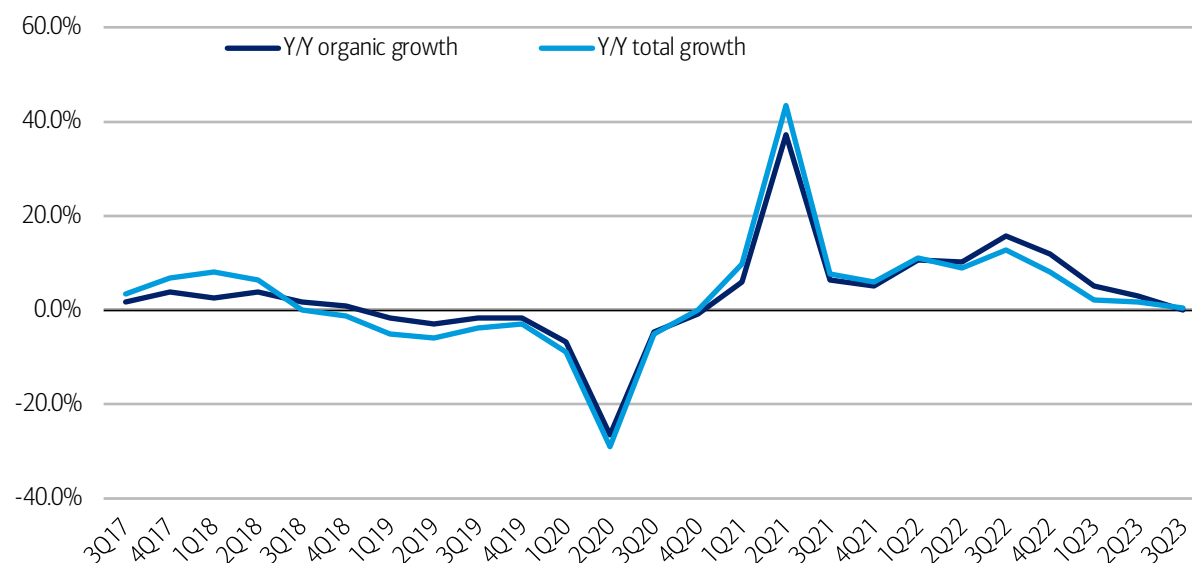
Source: BofA Global Research, company filings

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3Q23 organic growth review

Exhibit 6: ITW organic growth +0.2% y/y in 3Q23

Total organic y/y growth and revenue y/y growth

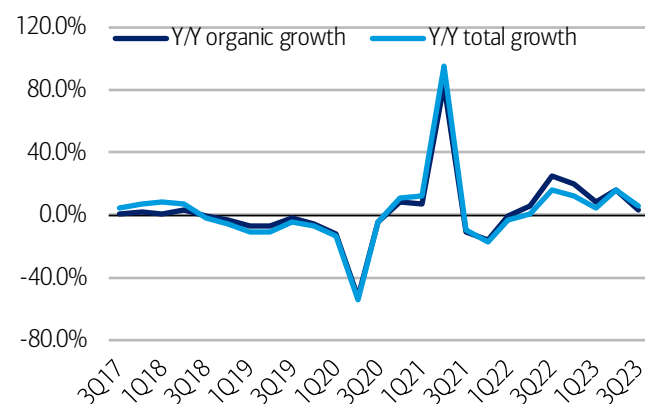


Source: BofA Global Research, company filings

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Exhibit 7: Automotive OEM organic growth up +3.8% y/y

Automotive OEM organic y/y growth and revenue y/y growth

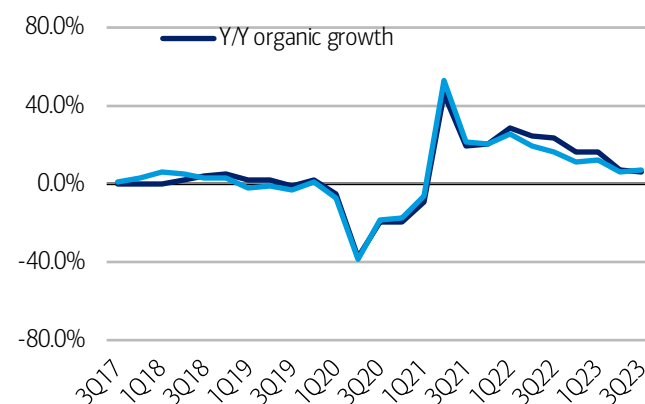


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Exhibit 8: Food Equipment organic growth up +6.3% y/y

Food Equipment organic y/y growth and revenue y/y growth

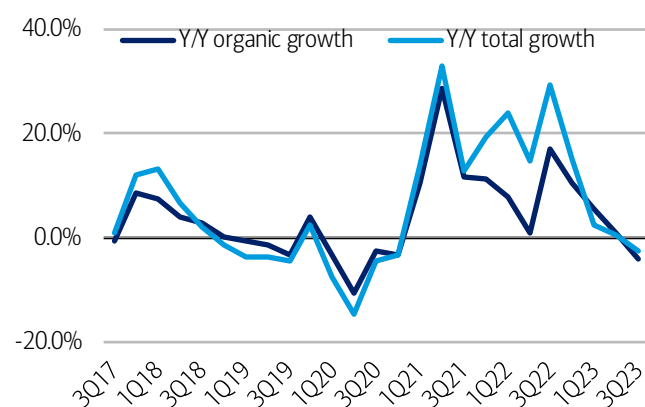


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Exhibit 9: Test & Measurement & Electronics organic growth down (3.9) y/y

T&M&E organic y/y growth and revenue y/y growth

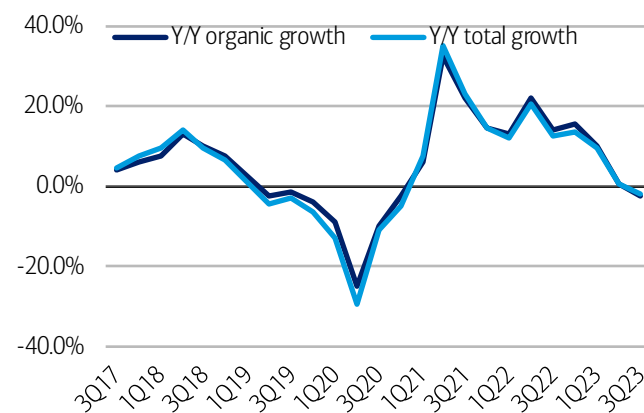


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Exhibit 10: Welding organic growth up down (2.4)% y/y

Welding organic y/y growth and revenue y/y growth

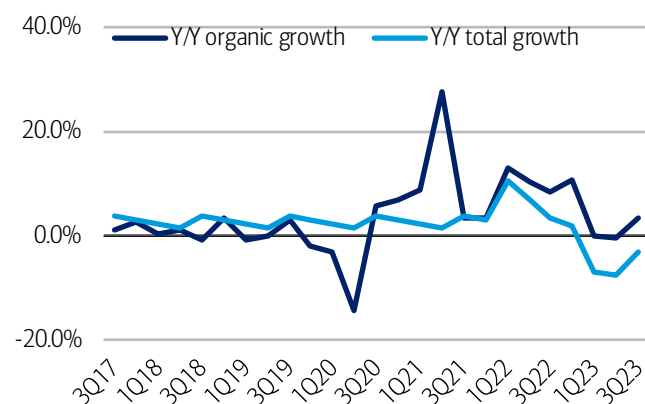


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Exhibit 11: Polymers and Fluids organic growth down (5.6)% y/y

Polymers and Fluids organic y/y growth and revenue y/y growth

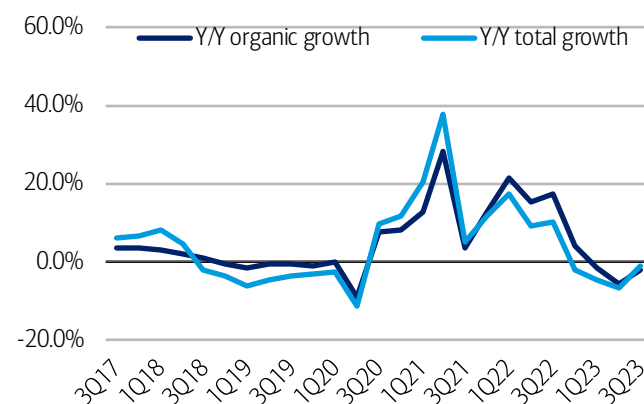


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Exhibit 12: Construction Products organic growth down (2.1)% y/y

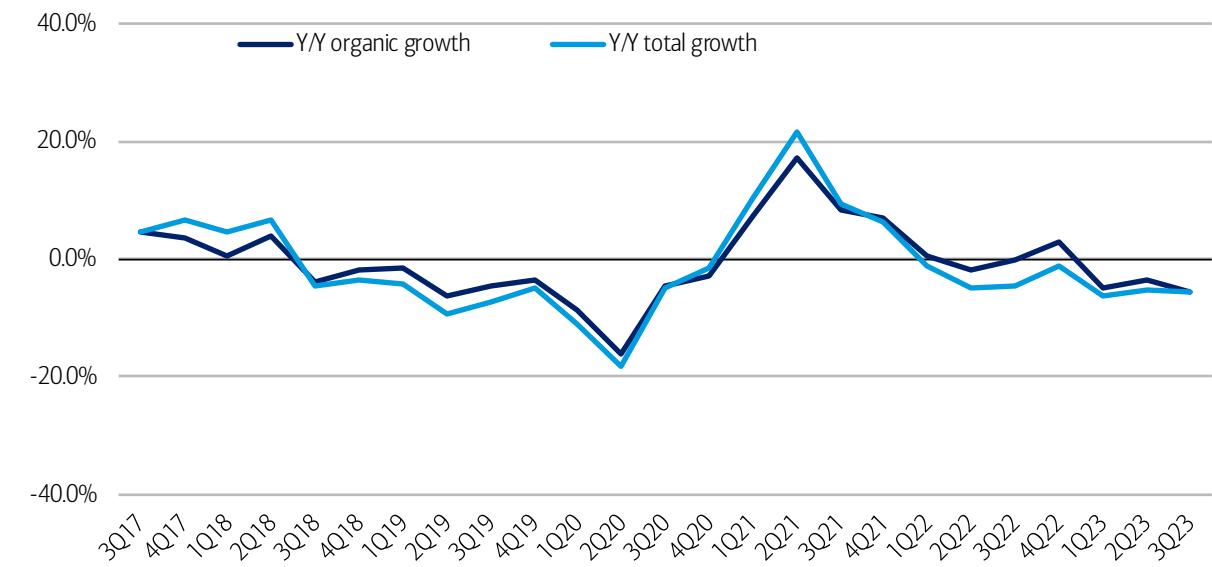
Construction Products organic y/y growth and revenue y/y growth



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Exhibit 13: Specialty Products organic growth down (5.6)% y/y
Specialty Products organic y/y growth and revenue y/y growth



Source: BofA Global Research, company filings

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Valuation

ITW currently trades in line with higher quality capital allocators, reflecting its high return on capital. Our \$260 price objective is based on a 17x multiple on our 2025 EV/EBITDA estimate (vs 18x 2024E previously), at a premium to the multi-industrial peer average trading 13x on 2024E, and in line with high quality compounders.

Exhibit 14: ITW relative valuation

ITW trades in line with high quality compounders

| Company | Ticker | Stock Price 10/24/2023 | P/E | | EV/EBITDA | | EBITDA Margin | | EPS Growth | |
|----------------------------------|--------|---------------------------|---------------|---------------|---------------|---------------|---------------|--------------|--------------|-------------|
| | | | 2024E | 2025E | 2024E | 2025E | 2024E | 2025E | 2024E | 2025E |
| Ametek | AME | \$141.25 | 21.2 x | 20.0 x | 16.4 x | 15.6 x | 30.6% | 30.9% | 6.6% | 6.0% |
| Dover | DOV | \$132.43 | 13.5 x | 12.2 x | 10.5 x | 9.7 x | 21.9% | 22.5% | 10.1% | 10.7% |
| Emerson | EMR | \$90.74 | 17.2 x | 15.8 x | 12.5 x | 11.7 x | 28.5% | 27.1% | 14.5% | 8.7% |
| Eaton | ETN | \$199.35 | 21.7 x | 20.3 x | 17.0 x | 16.1 x | 20.7% | 20.7% | 5.4% | 6.5% |
| Fortive | FTV | \$70.25 | 19.2 x | 17.8 x | 16.1 x | 15.1 x | 27.6% | 28.0% | 7.0% | 7.9% |
| Honeywell | HON | \$181.46 | 18.0 x | 16.1 x | 12.3 x | 11.3 x | 26.3% | 27.2% | 10.0% | 12.0% |
| Idex | IEX | \$192.74 | 22.5 x | 21.3 x | 16.9 x | 16.1 x | 25.8% | 25.0% | 7.9% | 5.2% |
| ITT | ITT | \$94.21 | 16.4 x | 15.0 x | 10.4 x | 9.6 x | 20.5% | 21.0% | 13.9% | 9.6% |
| Johnson Controls | JCI | \$48.72 | 11.7 x | 10.7 x | 8.7 x | 8.1 x | 15.9% | 16.5% | 13.7% | 9.2% |
| 3M | MMM | \$90.12 | 8.7 x | 8.2 x | 7.0 x | 6.6 x | 26.9% | 27.2% | 15.2% | 6.0% |
| Rockwell | ROK | \$265.86 | 17.4 x | 16.6 x | 14.6 x | 13.7 x | 22.7% | 23.2% | 20.1% | 4.8% |
| Trane Technologies | TT | \$186.83 | <u>19.6 x</u> | <u>18.1 x</u> | <u>13.9 x</u> | <u>13.1 x</u> | <u>17.7%</u> | <u>18.0%</u> | <u>7.9%</u> | <u>8.2%</u> |
| Average | | | 17.2 x | 16.0 x | 13.0 x | 12.2 x | 23.8% | 23.9% | 11.0% | 7.9% |
| ILLINOIS TOOL WORKS | | \$223.06 | 22.2 x | 20.3 x | 15.8 x | 14.9 x | 27.6% | 28.1% | 2.9% | 9.3% |
| ILLINOIS TOOL WORKS at PO | | \$260.00 | 25.9 x | 23.7 x | 18.2 x | 17.2 x | 27.6% | 28.1% | 2.9% | 9.3% |

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Price objective basis & risk

Illinois Tool Works (ITW)

Our \$260 PO is based on a 17x multiple on our 2025 EV/EBITDA estimate, at a premium to the multis average trading 13x on 2024E and in line with high quality compounders. We believe valuation in line with high quality compounders is warranted given best-in-class operating margins, strong history of capital allocation, and the potential for cyclical end market recovery.

Downside risks to our PO are 1) Auto volumes constrained for longer by supply chain, limiting near-term margin expansion, 2) near-term macro headwinds (e.g., slowing PMI) and 3) industrial short-cycle exposure into a recession. Upside risks to our PO are 1) cyclical end market recovery drives better than expected organic growth, 2) restructuring and fixed cost savings drive more margin expansion than anticipated, and 3) broader macro holds up.

Analyst Certification

I, Andrew Obin, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Multi-Industrials/Engineering and Construction Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|---------------------|------------------------------------|-------------|------------------|------------------------|
| BUY | | | | |
| | Ansys, Inc. | ANSS | ANSS US | Andrew Obin |
| | APi Group | APG | APG | Andrew Obin |
| | AspenTech | AZPN | AZPN US | Andrew Obin |
| | Atmus Filtration | ATMU | ATMU US | Andrew Obin |
| | Dover Corp | DOV | DOV US | Andrew Obin |
| | Eaton Corp PLC | ETN | ETN US | Andrew Obin |
| | Emerson Electric Co | EMR | EMR US | Andrew Obin |
| | Flowserve | FLS | FLS US | Andrew Obin |
| | General Electric Company | GE | GE US | Andrew Obin |
| | Honeywell International Inc. | HON | HON US | Andrew Obin |
| | Montrose Environmental Group, Inc. | MEG | MEG US | Andrew Obin |
| | Parker Hannifin Corporation | PH | PH US | Andrew Obin |
| | PTC Inc. | PTC | PTC US | Andrew Obin |
| | Rush | RUSHA | RUSHA US | Andrew Obin |
| | Vertiv | VRT | VRT US | Andrew Obin |
| NEUTRAL | | | | |
| | 3M Company | MMM | MMM US | Andrew Obin |
| | AMETEK Inc | AME | AME US | Andrew Obin |
| | Illinois Tool Works | ITW | ITW US | Andrew Obin |
| | ITT Inc. | ITT | ITT US | Andrew Obin |
| | Johnson Controls International PLC | JCI | JCI US | Andrew Obin |
| | Rockwell | ROK | ROK US | Andrew Obin |
| | Trane Technologies PLC | TT | TT US | Andrew Obin |
| | Vontier | VNT | VNT US | Andrew Obin |
| UNDERPERFORM | | | | |
| | Allegion | ALLE | ALLE US | Andrew Obin |
| | Carrier Global Corp. | CARR | CARR US | Andrew Obin |
| | Core & Main | CNM | CNM US | Andrew Obin |
| | John Bean Technologies | JBT | JBT US | Andrew Obin |
| | Keysight | KEYS | KEYS US | David Ridley-Lane, CFA |
| | Pentair plc | PNR | PNR US | Andrew Obin |
| RSTR | | | | |
| | Fortive Corporation | FTV | FTV US | Andrew Obin |

US - Multi-Industrials/Engineering and Construction Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|-------------------|---------|-------------|------------------|---------|
|-------------------|---------|-------------|------------------|---------|

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

EV / EBITDA

Basic EBIT + Depreciation + Amortization

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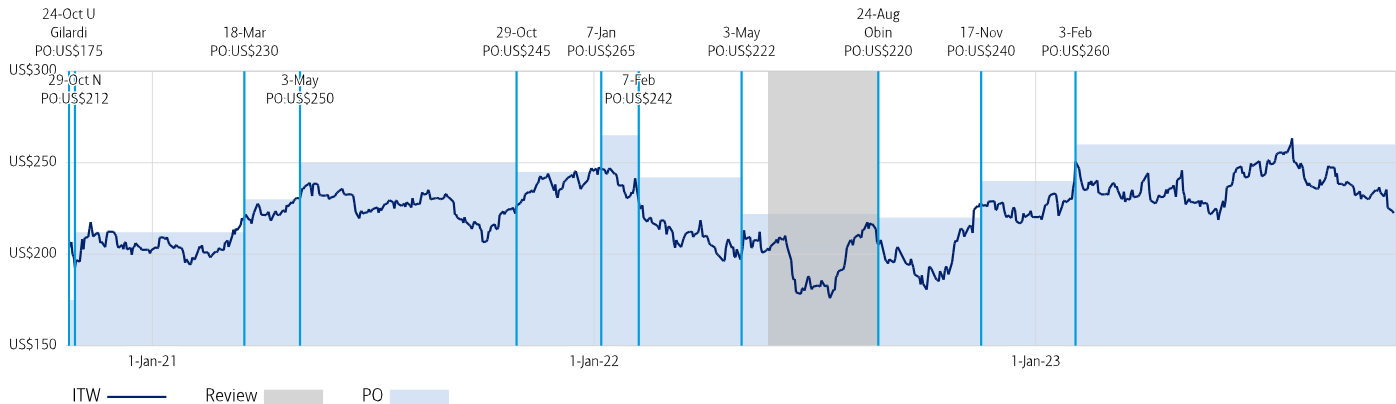
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Disclosures

Important Disclosures

Illinois Tool Works (ITW) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Industrials/Multi-Industry Group (as of 30 Sep 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 43 | 48.86% | Buy | 22 | 51.16% |
| Hold | 26 | 29.55% | Hold | 17 | 65.38% |
| Sell | 19 | 21.59% | Sell | 10 | 52.63% |

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 1869 | 53.48% | Buy | 1046 | 55.97% |
| Hold | 828 | 23.69% | Hold | 461 | 55.68% |
| Sell | 798 | 22.83% | Sell | 370 | 46.37% |

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster ^{R2} |
|-------------------|---|--|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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