

Illinois Tool Works

IHS February revisions: Europe/NA downside offsets China upside in '24

Reiterate Rating: UNDERPERFORM | PO: 235.00 USD | Price: 258.67 USD

IHS forecast revisions: (+) China, (-) everywhere else

Auto OEM is 20% of ITW sales but only 15% of operating profit. ITW is guiding for 3-5% organic growth in its Auto OEM segment in 2024. We believe that the margin bridge for the total company (guide for 40-140bps of y/y expansion) relies on auto volumes coming back. IHS Markit revisions for global auto builds were released on February 20. China builds for 2024 were revised up 2.8% MoM to +2.3% y/y. Elsewhere, build forecasts were revised downwards. All-in, global builds were revised up 4bps MoM to (0.4)% y/y. Our blended forecast of ITW markets by geography suggests weighted market growth sequentially worsened from (0.5)% y/y in January to (0.6)% y/y in February. On a quarterly basis, 1Q revisions were the most negative. We forecast +3% organic growth in Auto OEM next year, at the low end of guide. We see risk to this estimate. Reiterate Underperform, \$235 Price Objective.

China is a bright spot for ITW Autos (~18% of sales)

We think investors view the China Auto market as an upside risk to ITW (~18% of Auto OEM sales). In 2023, Auto OEM China growth of +21.9% y/y outperformed +10% y/y China auto builds. In 2022, Auto OEM China growth of +12.2% outgrew +6% y/y China auto builds. China market outgrowth is driven largely by EVs, where the company has higher content and is gaining share in China. ITW has lower electric vehicle content relative to ICE in the rest of its geographies. If China outperforms the market by ~12% again in 2024, but the rest of the business performs in line with geographies, this implies ~1% organic growth in 2024. Given ITW has performed in line with its markets over the past 6 years (median +1.1% outperformance) and underperformed in both North America and Europe in 2023, we view this framework as plausible. We note the North American underperformance spread in 2023 was exacerbated by high exposure to the Detroit 3 (~75% of North American sales, or ~30% of total Auto OEM sales) and product line simplification.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	9.77	9.74	9.87	10.79	11.45
EPS Change (YoY)	14.8%	-0.3%	1.3%	9.3%	6.1%
Consensus EPS (Bloomberg)			10.17	10.96	11.76
DPS	5.06	5.42	5.79	6.15	6.51
Valuation (Dec)					
P/E	26.5x	26.6x	26.2x	24.0x	22.6x
Dividend Yield	2.0%	2.1%	2.2%	2.4%	2.5%
EV / EBITDA*	20.6x	19.5x	19.1x	17.9x	17.1x
Free Cash Flow Yield*	2.5%	4.0%	4.0%	4.2%	4.4%

* For full definitions of *IQmethod*SM measures, see page 5.

23 February 2024

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Stock Data

Price	258.67 USD
Price Objective	235.00 USD
Date Established	10-Jan-2024
Investment Opinion	B-3-7
52-Week Range	217.06 USD - 267.12 USD
Mkt Val (mn) / Shares Out (mn)	77,830 USD / 300.9
Free Float	95.4%
Average Daily Value (mn)	292.73 USD
BofA Ticker / Exchange	ITW / NYS
Bloomberg / Reuters	ITW US / ITW.N
ROE (2024E)	106.4%
Net Dbt to Eqty (Dec-2023A)	245.5%
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"](#).

ICE: internal combustion engine

OEM: original equipment manufacturer

EV: electric vehicle-

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Timestamp: 23 February 2024 05:00AM EST

iQprofileSM Illinois Tool Works

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	23.3%	25.0%	25.1%	27.2%	29.2%
Return on Equity	90.4%	98.7%	106.4%	115.1%	110.0%
Operating Margin	23.8%	25.1%	24.7%	25.4%	25.7%
Free Cash Flow	1,936	3,082	3,092	3,256	3,445

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.8x	1.2x	1.2x	1.1x	1.1x
Asset Replacement Ratio	1.0x	0.8x	0.8x	0.8x	0.8x
Tax Rate	21.0%	22.7%	24.2%	24.8%	24.7%
Net Debt-to-Equity Ratio	228.4%	245.5%	277.3%	239.8%	200.3%
Interest Cover	18.7x	15.2x	14.2x	17.0x	19.0x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	15,936	16,115	16,637	17,373	18,123
% Change	10.2%	1.1%	3.2%	4.4%	4.3%
Gross Profit	6,507	6,799	6,937	7,243	7,556
% Change	9.1%	4.5%	2.0%	4.4%	4.3%
EBITDA	4,200	4,454	4,531	4,828	5,076
% Change	8.1%	6.1%	1.7%	6.6%	5.1%
Net Interest & Other Income	52	(217)	(240)	(209)	(195)
Net Income (Adjusted)	3,034	2,957	2,934	3,159	3,352
% Change	12.6%	-2.5%	-0.8%	7.7%	6.1%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	3,034	2,957	2,934	3,159	3,352
Depreciation & Amortization	410	414	418	422	427
Change in Working Capital	(818)	(138)	104	40	52
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(278)	171	(31)	(18)	(24)
Capital Expenditure	(412)	(322)	(333)	(347)	(362)
Free Cash Flow	1,936	3,082	3,092	3,256	3,445
% Change	-14.4%	59.2%	0.3%	5.3%	5.8%
Share / Issue Repurchase	(1,721)	(1,500)	(1,500)	(1,100)	(1,100)
Cost of Dividends Paid	(1,542)	(1,646)	(1,720)	(1,799)	(1,904)
Change in Debt	276	476	(340)	0	(996)

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	708	1,120	652	1,009	453
Trade Receivables	3,171	3,251	3,219	3,219	3,209
Other Current Assets	2,391	2,409	2,389	2,452	2,515
Property, Plant & Equipment	1,848	1,892	1,943	2,006	2,081
Other Non-Current Assets	7,304	7,169	7,032	6,894	6,754
Total Assets	15,422	15,840	15,235	15,580	15,013
Short-Term Debt	1,590	0	0	0	0
Other Current Liabilities	3,143	3,103	3,155	3,259	3,364
Long-Term Debt	6,173	8,239	7,899	7,899	6,903
Other Non-Current Liabilities	1,427	1,598	1,567	1,549	1,526
Total Liabilities	12,333	12,940	12,621	12,707	11,793
Total Equity	3,089	2,900	2,614	2,873	3,221
Total Equity & Liabilities	15,422	15,840	15,235	15,580	15,013

* For full definitions of iQmethodSM measures, see page 5.

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 20% of sales, Food Equipment 16%, Test & Measurement 17%, Welding 12%, Polymers & Fluids 11%, Construction Products 12%, and Specialty Products 10%. 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. The company has executed well but struggles to grow. Organic growth has been lackluster and we see margin challenges in 50% of the company in 2024. We see risk of multiple de-rating as '24 is likely to be another year of below-average growth for ITW.

Stock Data

Average Daily Volume 1,131,676

Quarterly Earnings Estimates

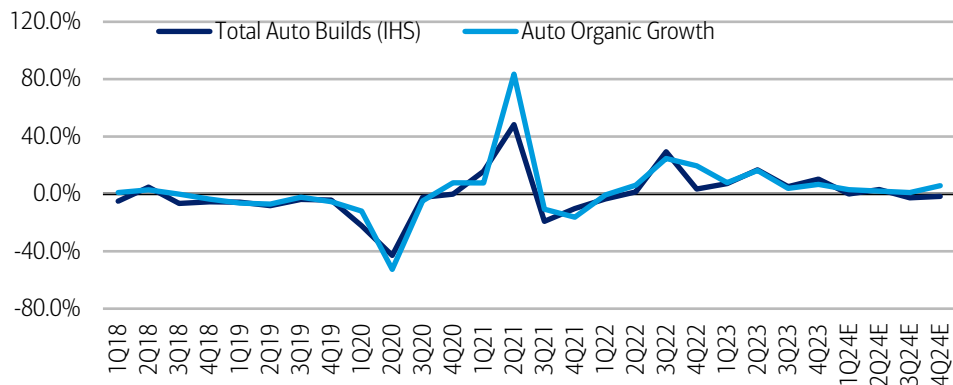
	2023	2024
Q1	2.33A	2.34E
Q2	2.48A	2.42E
Q3	2.55A	2.55E
Q4	2.38A	2.57E

Auto OEM summary

Auto OEM topline is correlated tightly with auto production volumes. Given declining y/y 2024E auto production volumes, we see risk to company guidance of 3-5% organic growth. The company has higher EV share and content per vehicle in China, and anticipates faster growth in this market in 2024. Given underperformance in 2023 in its other geographies, we continue to see risks to the outlook.

Exhibit 1: IHS Global Production forecast vs. Auto OEM organic growth

93% correlation, 1Q18-4Q23

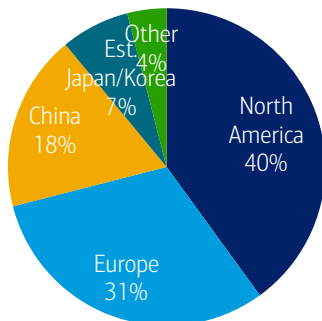


Source: BofA Global Research, company files

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Exhibit 2: Auto OEM geographic breakdown

We estimate China grew from ~16% of the segment in 2022 to ~18% in 2023

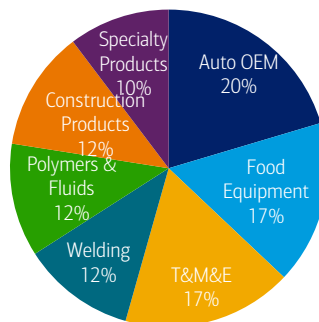


Source: BofA Global Research, company files

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Exhibit 3: ITW sales by segment, 2024E

Auto OEM is the largest segment by sales



Source: BofA Global Research, company files

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Price objective basis & risk

Illinois Tool Works (ITW)

We base our \$235 price objective on 16x 2025E EV/EBITDA. This compares to the peer average at 15x and high-quality compounders at 18x. We maintain a slight premium to the industrial group given above-average EBITDA margins.

Upside risks to our PO are 1) Auto production volumes revised upward, driving better near-term margin expansion and topline, 2) Welding price/cost and volumes better than expected, and 3) T&M&E recovers from cyclical downturn faster than forecasted. More margin expansion vs. our forecast would alleviate pressure on the multiple and drive positive earnings revisions. Downside risks are: 1) Auto volumes remain depressed, limiting near-term margin expansion, 2) investor sentiment pressured more than expected on lackluster earnings growth.

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

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BUY				
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	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
	ITT Inc.	ITT	ITT 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
	Vontier	VNT	VNT US	Andrew Obin
NEUTRAL				
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	AMETEK Inc	AME	AME US	Andrew Obin
	Fortive Corporation	FTV	FTV US	Andrew Obin
	Johnson Controls International PLC	JCI	JCI US	Andrew Obin
	Pentair plc	PNR	PNR US	Andrew Obin
	Rockwell	ROK	ROK US	Andrew Obin
	Trane Technologies PLC	TT	TT US	Andrew Obin
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	Illinois Tool Works	ITW	ITW US	Andrew Obin
	John Bean Technologies	JBT	JBT US	Andrew Obin
	Keysight	KEYS	KEYS US	David Ridley-Lane, CFA

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

Basic EBIT + Depreciation + Amortization

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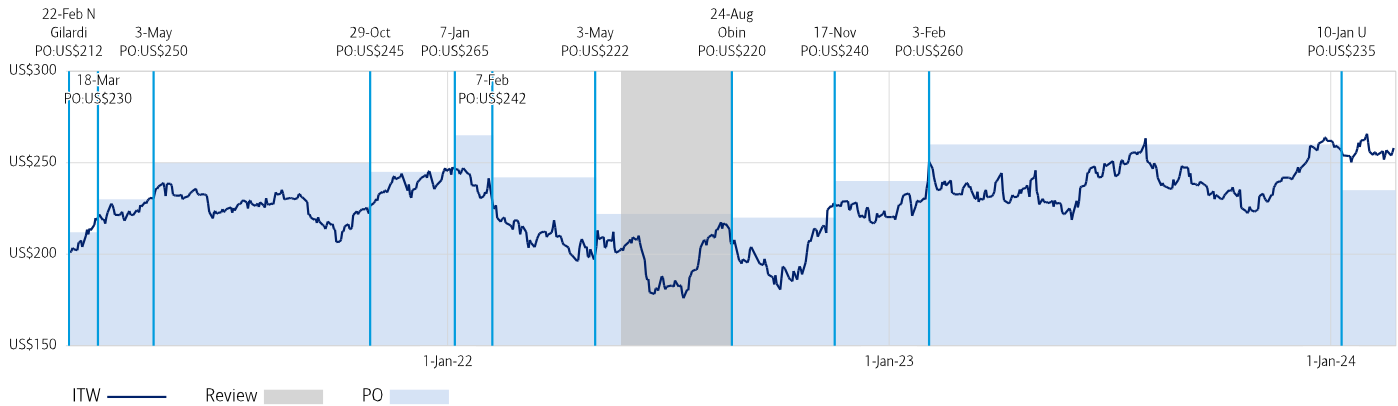
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Illinois Tool Works (ITW) Price Chart



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 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	45	50.56%	Buy	25	55.56%
Hold	26	29.21%	Hold	13	50.00%
Sell	18	20.22%	Sell	7	38.89%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{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.

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^{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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