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Snap-on's (SNA) CEO Nick Pinchuk on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-17-19 Earnings Summary

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EPS of \$2.96 beats by \$0.03 | Revenue of \$901.8M (0.41% Y/Y) misses by \$-7.43M

Earning Call Audio



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Snap-on Incorporated (NYSE:SNA) Q3 2019 Earnings Conference Call October 17, 2019
10:00 AM ET

Company Participants

Sara Verbsky – Vice President-Investor Relations

Nick Pinchuk – Chief Executive Officer

Aldo Pagliari – Chief Financial Officer

Conference Call Participants

Gary Prestopino – Barrington Research

David Leiker – Baird

Bret Jordan – Jefferies

David MacGregor – Longbow Research

Curtis Nagle – Bank of America

Christopher Glynn – Oppenheimer

Scott Stember – CL King

Operator

Ladies and gentlemen, good day and welcome to the Snap-on Third Quarter 2019 Results Investor Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Sara Verbsky, Vice President of Investor Relations. Please go ahead ma'am.

Sara Verbsky

Thank you, Abby, and good morning, everyone. Thank you for joining us today to review Snap-on's third quarter results, which are detailed in our press release issued earlier this morning.

We have on the call today, Nick Pinchuk, Snap-on's Chief Executive Officer; and Aldo Pagliari, Snap-on's Chief Financial Officer. Nick will kick off our call this morning with his perspective on our performance. Aldo will then provide a more detailed review of our financial results. After Nick provides some closing thoughts, we'll take your questions.

As usual, we have provided slides to supplement our discussion. These slides can be accessed under the Downloads tab in the webcast viewer as well as on our website, snapon.com, under the Investors section. These slides will be archived on our website, along with the transcript of today's call.

Any statements made during this call relative to management's expectations, estimates or beliefs, or otherwise state management's or the company's outlook, plans or projections, are forward-looking statements, and actual results may differ materially from those made in such statements. Additional information and the factors that could cause our results to differ materially from those in the forward-looking statements are contained in our SEC filings.

Finally, this presentation includes non-GAAP measures of financial performance, which are not meant to be considered in isolation or as a substitute for their GAAP counterparts. Additional information, including a reconciliation of non-GAAP measures, is included in our earnings release and in our conference call slides on pages 14 through 17. Both can be found on our website.

With that said, I'd now like to turn the call over to Nick Pinchuk. Nick?

Nick Pinchuk

Thanks, Sara. Good morning, everybody. Today I'll start with the highlights of our third quarter. I'll give you update – an update on the environment and the trends we see. I'll take you through some of the turbulence we've encountered and I'll speak about our physical and financial progress. Aldo will then provide a more detailed review of the financials.

We believe that our third quarter again demonstrated Snap-on's ability to continue its trajectory of positive results, overcoming periodic and regional variation. The full third quarter results did demonstrate encouraging elements of progress that were somewhat attenuated by turbulence and challenged geographies and by the impact of unfavorable foreign currency. Like the last quarter, we had continuing progress in the U.S., up overall 3.2% with clear growth across our operations and across our groups. And again, this quarter that advancement was muted by a continuing pause in Europe, primarily in the UK, but also in country – in the Nordic countries, in Germany and Italy, several of the bellwether markets.

And as I've said, there was also a meaningful impact from currency translation and transaction. So we had significant headwinds, but once again, our advantages prevailed. Organic sales were up 1.4%. Sales gains in the critical industries in OEM dealerships and diagnostics and information for independent repair shop owners and continued growth in the U.S. van channel; advancements in hand tools, diagnostics, repair information, customized tool sets and software. It all combined to meet the turbulence and the variation and it moved us forward again.

Opco operating income before financial services of \$167.7 million compared to \$173.1 million last year, and it included \$4.4 million of unfavorable foreign currency. RCI was evident in the quarter, but it was not – it wasn't able to offset the negative foreign currency, the weakness in Europe and the investments that we're making in the field – in field support and training for the Tools Group that's aimed at enabling our powerful new products.

For financial services, operating income of \$61 million grew \$1.7 million from last year's \$59.3 million. That result combined with opco for a consolidated operating margin of 23.2% compared with 23.7% last year. Quarterly EPS at \$2.96 was up \$0.11 or 3.9% above last year – of last year's \$2.85 or 2.8% above last year's adjusted EPS, which excludes the one-time U.S. tax legislation transition charge that was in the 2018 third quarter results.

So now let's speak about the markets. We believe the automotive repair environment continues to be favorable. The Tools Group had registered a similar performance to the second quarter with a rise in the U.S., being offset by turbulence in international geographies. We believe we occupy a position of significant potential with the Tools Group. Vehicles are getting more complex. Our products are clearly keeping pace. The face to face positioning of our franchisees are perfect to guide technicians in wielding those powerful devices effectively. It's a great advantage in this changing environment and a considerable opportunity as we train our franchisees to provide that special guidance efficiently.

On the other side of automotive repair – of auto repair, Repair Systems & Information or the RS&I Group, encouraging progress in the quarter, expanding Snap-on's presence with repair shop owners and managers with a broad range of continually improving products; more intelligent, more comprehensive and more capable. The shops are changing and upgrading both dealerships and independents, and RS&I is capitalizing on that trend, helping the shop fix vehicles right the first time and it's paying off. For the critical industries, verticals like military, education, aerospace, important segments, we see significant progress. We like the quarter for critical industries, we like the way they're sounding and we like the way they're trending.

We do believe we're well positioned to confront the challenges and make progress along our runways for growth. At the same time though, it's clear that we have ongoing potential on our runways for improvement. The Snap-on Value Creation Processes, safety, quality, customer connection, innovation, Rapid Continuous Improvement or RCI, they've never been more important than these periods of multiple headwinds. They're a constant driver of our progress, helping counter the turbulence, especially customer connection, understanding the work of professional technicians and innovation, matching that insight with technology. And in this quarter, Snap-on Value Creation, customer connection and innovation drove growth in the face of challenges and led to more prestigious product awards.

Just in this quarter, Snap-on was prominently represented with 13 Professional Tool & Equipment News, PTEN, People's Choice Awards. These are the awards where the actual users, the technicians make the selection. We have 13. We're also recognized with six PTEN Innovation Awards, and we were honored with three MOTOR Magazine Top 20 awards. An essential driver of Snap-on growth, Snap-on's power, is innovative product that makes work easier. It's always been our strength. And these awards, hard won, are testimony that great Snap-on products just keep coming, matching the growing complexity of the task, maintaining forward progress. That's the environment.

Now we'll move to the individual operating groups. Let's start with C&I. Sales of \$335.3 million in the quarter, increased \$5.5 million, including \$1.1 million from acquisitions and \$5.5 million of unfavorable foreign currency translation. Organic growth was \$9.5 million or 2.9% and that was gained pretty much across all the divisions.

Operating margins were lower 14.4% versus the 16.1% recorded last year. That's primarily reflecting critical – the critical industry sales being more weighted in this quarter towards the lower margin military sector. From a broad perspective, C&I focused on critical industries, outside the vehicle garage showed broad-based gains with another year-over-year increase now accomplished for 13 straight quarters.

We continue to rise in critical industries. We see it as a very good positive. It's a favorable market environment and we're addressing it with innovative new products aimed at solving tasks of consequence and results encouraging. The third quarter did see advancements in

new products like our new power tool, our new CT9075 half-inch cordless impact wrench, the best balance of power and weight in the market, a five-amp power lithium battery, 900 foot pounds of sustained bolting force, 1,250 foot pounds of breakaway torque. That's big power.

But beyond the power, the CT9075 it's been designed and manufactured for long service life with best-in-class key components, high torque brushless motor, a full body impact hammer and a very robust anvil, with both the hammer and the anvil, key components for any power tool, any impact power tool, manufactured in our Murphy, North Carolina plant using special alloy steel, a material employed when superior toughness and superior strength are paramount.

We believe and testing shows that our new impact has a clear durability advantage, holding its power for many more cycles even when removing the most tightly torque fasteners. When the work is critical, the CT9075 is the answer faster, more powerful, tougher. Now we only released it to a few of our regions, but where it's been available, it's been a huge hit. Word travels fast, and technicians all over the country are pumped. They want this tool. It's already hit our \$1 million product list and it's on its way to much, much more. Customer connection showed us what we needed to make a difference, speed, durability and power and the CT9075 has all that and the market reception confirms it.

In this quarter, from our FASTORQ acquisition, we also added to our industrial torque and tensioning key product lines from penetrating industrial – the critical industries. We added offerings by – torque and tensioning offerings by introducing the pneumatic SpinTORQ 360 degree torque wrench, utilizes a double-enveloping worm gear design. It's unique. It's a unique and focused product developed for critical industries and offering a significant speed advantage over standard ratcheting hydraulic wrenches because the SpinTORQ continually rotates the fastener, while – rather than turning what hydraulics – rather than doing what hydraulics do, turning a few degrees, ratcheting back and forth, and then repeating. Bolting time with the SpinTORQ is greatly reduced.

But the new wrench, not only faster, it's also operates with higher accuracy. A built-in torque control stall system delivers a bolting tension within plus or minus 5%, an uncommonly narrow range. It's also safer. The secondary trigger design focuses

operators, forces operators to keep their hands away from pinch points, avoiding serious accidents that can happen. It's especially effective in oil and gas, power generation and mining where downtime is critical and higher travel distances for fasteners can be a significant time challenge.

We launched SpinTORQ in July and as expected the reception of critical initiatives has been strong. Products like these aimed at tasks of increasing complexity that help drive our progress across the critical initiatives and we'll keep working customer connection and innovation. So the advancements keep coming. C&I maintaining its momentum, extending in critical industries, moving Snap-on outside of the garage and it's working.

Now onto the Tools Group, organic sales flat, down 0.3%, continued growth in the U.S. up low single-digits, continued growth in the U.S. up low single-digits was offset again by variation internationally. Operating income in the quarter of \$53 million, including the effect of negative foreign currency and the cost of investing in – was affected by negative currency and negative foreign currency and the cost of investing in more field support and training that compares to \$59.3 million in 2018. Now the third quarter is when we hold our annual Snap-on Franchisee Conference or SFC.

This year, it was in Washington, more than 8,000 people were there, franchisees, their guests and the Snap-on team. We had sales and profit growth seminars and extensive training and intelligent diagnostics. It was all combined with 141,000 square foot product expo, showcasing our latest innovations. For the franchisees, it's an opportunity for learning, for touching and ordering new products and for recharging their Snap-on batteries.

And for the company, it's an opportunity to gauge our franchisees' outlook on the business. Well, one measure order volume was up mid single-digits off the SFC with most product categories showing gains over last year. And I spoke to with many of the franchisees during the weekend and I can attest they display a lot of confidence in our business and considerable optimism in their future with Snap-on. We do believe our franchisees continue to grow stronger and we're continuing to invest in their future.

And if you are with us at DC, you could see it clearly. We're investing in field support and training. We're investing in building our franchisees' ability to use their direct interface with technicians to communicate the unique capability of the Snap-on product line. We did that at the SFC and the diagnostic training session, well attended and well appreciated and it was a clear success.

We have confidence in the power of our product line and there are real reasons for the confidence. You heard about the product awards. Well beyond that, there's a continuous stream of other great new offerings, attention getters that make repairs easier and most of the challenges and attention getters that make repairs easier and meet the challenges of increasing vehicle complexity.

You're convinced of this when you see the innovations like our Snap-on FJ175, an exclusive 1.75 ton high performance aluminum jack manufactured in our Elkmont, Alabama facility. It's only 47 pounds. One of the benefits of having aircraft grade aluminum chassis components, at that lightweight, it's very portable, perfect for off – on the road repairs outside the garage. It's capable of lifting up to 3,500 pounds. It elevates up to 18 inches and features a low entry point of 3.4 inches. It can accommodate the range of vehicles, low ride to hard ride, low ride to high ride that challenges the repair shops of today.

It's got a premium pump, improved hydraulics and higher compound ratio so it works effectively even with one hand, a considerable field advantage actually. The diamond knurl handle improves the grip and the unit's portable design makes it great for a wide variety of situations.

Now let's talk about tool storage, among the new products launched, the SFC – SFC was the highly anticipated double-bank EPIQ utility vehicle both massive storage capacity of over 128,000 cubic inches. It's dubbed the EUV. It's a giant box. That includes our signature SpeedDrawer and Power Locker features that are aimed at making it easier for customers to keep their drawers organized and their power tools fully charged with five outlets and two USB ports.

The new unit has clear visual appeal. It's a design that evokes a race team pit way and everybody wants one. Striking 17 – it's got striking 17 inch wheels and a number of unique custom details like a special Snap-on logo center wheel cap, a distinction that's only available on the EUV. It's available in several colors and it is a mobile monster and it's still like it. It's designed to handle the very large tool loads by reinforcing the standard corner gussets in a scene construction with additional top, bottom and side support, it's our strongest ever roll cab and I kind of test, it was a center of attention at the SFC tool show, innovation and eye appeal, a winning combination. Well, that's the Tools Group, enthusiastic SFC, continued growth in the U.S., and innovative new products driving the way forward.

Now RS&I, organic sales were up 3.2% with mid-single-digit increases in both sales to OEM dealerships and sales of diagnostics and repair – sales of diagnostics and repair information to independent shops. Those gains were partially offset by a low-single-digit decline in the sales of undercar equipment, particularly reflecting weaker sales in Europe. Despite the higher mix of sales in OEM, essential programs, which tend to have a lower operating margin than the group average, RS&I OI margin was 25.8% quite strong, a rise of 10 basis points from the last year.

Once again, RCI innovation and software drove the progress and overcame the headwinds. Our Mitchell 1 division continued to expand its array of industry-leading productivity solutions by releasing its latest edition of our pro-demand repair information software, which includes new enhancements to wiring and proponent diagrams, select the replacement part, pro-demand now opens a specific component diagram of that item, no needed to scroll through multiple pages, a big time saver. The new software also clearly highlights related wires in the surrounding harness, more time saved. Both of those productivity features are industry first and they're quite popular.

We also launched other great products in the period, products like our M525F enhanced digital multimeter, another of our next generation horizontal multimeters. The units has a larger four inch color display for easier reading and quicker symbol identification. Today, interpreting a wide range of electrical impulses is necessary for diagnosing the circuit or component problems of today's vehicles. The new enhanced multimedia measures ohms

and AC, DC voltage and true RMS, AC, DC amperage frequency and capacitance, and a rate covering most automotive electrical needs, and it's safe. It's safe for use on hybrid that's confirmed by its CAT III 1,000 volt and CAT IV 600 volt hybrid safety ratings.

In addition, it's got some clever special operating conveniences like test lead storage and built-in tilt stand. Initial product launch was strong and made the multimeter another of our hit products. So to wrap up RS&I, growth in OEM dealerships improving position with repair shop – independent repair shop owners and managers, expanding product lines, maintaining and improving strong margins. Well, that's the highlights of our quarter.

C&I; continuing its positive trends, extending across critical industries, Tools Group; matching the rise in vehicle complexity, RS&I, expanding in the shop, building sales and profitability. Progress along our runways for coherent growth and advancements down our runways for improvement and EPS \$2.96 in the quarter, 2.8% higher than last year, progress hard won against turbulence is encouraging.

Now I'd turn the call over to Aldo. Aldo?

Aldo Pagliari

Thanks, Nick. Our consolidated operating results have summarized on Slide 6. Net sales of \$901.8 million in the quarter were up 0.4% reflecting a 1.4% organic sales gain, \$2.9 million of acquisition related sales and \$11.7 million of unfavorable foreign currency translation. The organic sales gain this quarter reflected low-single-digit growth in both the commercial and industrial and the Repair Systems and Information segments.

Sales in the Snap-on Tools segment were essentially flat, but included low-single-digit gains in the U.S. franchise operations. Similar to last quarter, on a year-over-year basis, sales to customers in the United States increased across all segments while sales in Europe, particularly the United Kingdom, continue to exhibit weakness. Consolidated gross margin of 49.7% compared to 50.5% last year. The 80 basis point decrease primarily reflects increased sales in lower gross margin businesses, 20 basis points of unfavorable foreign currency effects, partially offset by savings from RCI initiatives.

The operating expense margin of 31.1% improved 10 basis points from 31.2% last year. Operating earnings before financial services of \$167.7 million, including \$4.4 million of unfavorable foreign currency effects, compared to \$173.1 million last year. As a percentage of net sales, operating margin before financial services of 18.6%, including 20 basis points of unfavorable foreign currency effects, compared to 19.3% last year.

Financial services revenue of \$84.1 million and operating earnings of \$61 million increased 2.6% and 2.9%, respectively, from 2018, primarily reflecting year-over-year growth in our financial services portfolio. Consolidated operating earnings of \$228.7 million, including \$4.7 million of unfavorable foreign currency effects, compared to \$232.4 million last year. As a percentage of revenues, the operating earnings margin of 23.2% compared to 23.7% last year.

Our third quarter effective income tax rate of 23.5% compared to 24% last year. During Q3 2018, our tax rate included a 90 basis point charge related to the implementation of tax legislation in the United States. Finally, net earnings on \$164.6 million, \$2.96 per share, including a \$0.06 unfavorable impact associated with foreign currency compared to \$163.2 million or \$2.85 per share a year ago. In Q3 2018, excluding a \$0.03 per share charge related to taxes, adjusted earnings per share was \$2.88.

Now let's turn to our segment results. Starting with C&I Group on Slide 7, sales of \$335.3 million in the quarter increased 1.5%, reflecting a 2.9% organic sales gain and \$1.1 million of acquisition-related sales, partially offset by \$5.5 million of unfavorable foreign currency translation. The organic growth included a mid-single-digit gain in our specialty tools business, as well as low-single-digit increases in both the segment's European-based hand tools business and to customers in critical industries, particularly sales to the U.S. military.

Gross margin of 37.9% decreased 170 basis points year-over-year, primarily due to increased sales and lower gross margin businesses, including the aforementioned sales to the military. The operating expense margin of 23.5% was unchanged from last year. Operating earnings for the C&I segment of \$48.3 million decreased \$4.7 million from last year, and the operating margin of 14.4% compared to 16.1% in 2018.

Turning now to Slide 8. Sales in the Snap-on Tools Group of \$385.2 million decreased 1.2%, primarily due to \$3.3 million of unfavorable foreign currency translation. Organic sales were essentially flat, reflecting a mid-single-digit decline internationally, partially offset by a low-single-digit increase in the United States. Gross margin of 43.4% including 60 basis points of unfavorable foreign currency effects decreased 20 basis points from last year. The operating expense margin of 29.6% increased from 28.4% last year, primarily due to higher field support investments.

Operating earnings for the Snap-on Tools Group of \$53 million, including \$2.7 million of unfavorable foreign currency effects, decreased \$6.3 million from last year, while the operating margin of 13.8%, including 50 basis points of unfavorable foreign currency effects, compared to 15.2% in 2018.

Turning to the RS&I Group shown on Slide 9. Sales of \$322.7 million increased 2.6%, reflecting a 3.2% organic sales gain and \$1.8 million of acquisition related sales, partially offset by \$3.6 million of unfavorable foreign currency translation. The organic sales increase includes mid-single-digit gains in both sales to OEM dealerships and in sales of diagnostics and repair information products to independent repair shop owners and managers. These increases were partially offset by a low-single-digit decline in sales of undercar equipment, reflecting weaker sales in Europe.

Gross margin of 47.7% decreased 100 basis points from 48.7% last year, primarily due to the increased sales to OEM dealerships through the equipment solutions operation, which tend to have lower gross margins and lower operating expenses associated with such activity. The operating expense margin of 21.9% improved 110 basis points from 23% last year, primarily due to the aforementioned effect of higher sales to OEM dealerships and benefits from RCI initiatives. Operating earnings from the RS&I Group of \$83.3 million increased \$2.6 million from last year, and the operating margin of 25.8% compared to 25.7% a year ago.

Now turning to Slide 10. Operating earnings from financial services of \$61 million increased 2.9% versus the third quarter of 2018. Revenue of \$84.1 million was up 2.6% from a year ago. Financial services expenses of \$23.1 million compared to \$22.7 million last year. As a percentage of the portfolio, financial services expenses were 1.1% in the

third quarters of both 2019 and 2018. The average yield on finance receivables was 17.7% in the third quarter of 2019 and in the third quarter of 2018. The average yield on contract receivables was 9.2% in both periods.

Total loan originations of \$253.5 million decreased \$13.5 million or 5.1%, primarily due to a decrease in originations of finance receivables, resulting from lower year-over-year Snap-on Tools franchisee sales of big-ticket items that utilize extended credit.

Moving to Slide 11. Our quarter end balance sheet includes approximately \$2.1 billion of gross financing receivables, including \$1.8 billion from our U.S. operation. Our worldwide gross financial services portfolio grew \$12.3 million in the third quarter. The 60-day-plus delinquency rate of 1.7% for U.S. extended credit remains stable and reflects the seasonal increase we typically experience in the third quarter. As it relates to extended credit for finance receivables, the largest portion of the portfolio, trailing 12 month net losses of \$49.9 million, represented 2.97% of outstandings at quarter end, down 3 basis points sequentially, supporting continued stabilization of the portfolio's credit metric performance.

Now turning to Slide 12. Cash provided by operating activities of \$131.1 million in the quarter, increased \$1.3 million from comparable 2018 levels, primarily do the higher net earnings. Net cash used by investing activities of \$76.8 million included net additions to finance receivables of \$15.4 million, capital expenditures of \$29.6 million and \$29.6 million for the acquisition of Cognitran, which specializes in flexible, modular and highly scalable software as a service products for OEM customers and their dealers.

Net cash used by financing activities of \$49.5 million included cash dividends of \$52.3 million and the repurchase of 400,000 shares of common stock for \$59.7 million under our existing share repurchase programs. As of the end of September, we had remaining availability to repurchase up to an additional \$390.6 million of common stock under existing authorizations.

Turning to Slide 13. Trade and other accounts receivable decreased \$7.8 million from 2018 year end. Days sales outstanding of 66 days compared to 67 days in 2018 year end. Inventories increased \$79.7 million from 2018 year end, primarily to support higher levels

of demand across critical industries, including demand for U.S. manufactured hand tools, new products as well as to improve service levels to our customers. On a trailing 12 month basis, inventory turns of 2.6 compared to 2.9 at year end 2018.

Our quarter end cash position of \$167.5 million increased \$26.6 million from 2018 year end levels. Our net debt-to-capital ratio decreased to 23.5% from 24.2% at year end 2018. In addition to cash and expected cash flow from operations, we have more than \$800 million in available credit facilities as we entered into a new five year \$800 million multi-currency revolving credit facility on September 16, which amends and restates the previous facility. As of quarter end, we had \$218.8 million of commercial paper borrowings outstanding, an increase of \$41.7 million since year end 2018.

That concludes my remarks on our third quarter performance, and I'll now turn the call back to Nick for his closing thoughts. Nick?

Nick Pinchuk

Thanks, Aldo. Well, that's our third quarter. The results demonstrate encouraging elements of progress attenuated by turbulent geographies and by unfavorable perms. Overall organic growth at 1.4%, the results of progress in the U.S. growing at 3.2% challenged by slippage in Europe, where sales decreased and slide – and there was slides in the UK, the Nordic countries and German. The Tools Group about flat, decreasing 0.3% continued modest growth in the U.S. offset by international turbulence, increasing vehicle complexity matched by powerful new products and investment in training, making it possible for the franchisees to sell our enhanced offerings and the unique capabilities that they have effectively. Enabling franchisees to leverage their face to face advantage.

C&I up 2.9% organically, with each division contributing to the continuing extension in critical industries and RS&I rising 3.2% organically, further progress and expanding with OEM dealerships and independent shop, hardware and software driving growth. Overall OI margin of 18.6%, down 70 basis points, but still strong given the turbulence. It all came together for an EPS of \$2.96, up 2.8% as adjusted, despite the challenges.

Our markets, vehicle technicians, critical industries, emerging economies, and repair shop owners and managers offer ongoing opportunity and we believe we have the position, the capability and the focus to take advantage of those possibilities and to continue our positive trend through the end of this year and on into 2020 and beyond.

Before I turn the call over to the operator, I'll talk directly to our franchisees and associates. I know many of you are listening. When I speak of position of capability in a focus, I speak of you. The gains we've made and the advancements we anticipate reflect your extraordinary contributions. For the progress you've achieved, you have my congratulations and for your unfailing commitment and dedication to our team, you have my thanks.

Now I'd turn the call over to the operator. Operator?

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] And we will take our first question from Gary Prestopino with Barrington Research.

Gary Prestopino

Hey, good morning everyone.

Nick Pinchuk

Good morning, Gary Prestopino.

Gary Prestopino

Thanks. Hey Nick, could you maybe just give us your best guess and your thoughts on if we get a Brexit deal, how that is – how that impacts your UK, as well as your European business?

Nick Pinchuk

It's hard to judge, but what – it's like this, the pound, just talking about the pound, it's worth 40% of the profit impact and about a third of the sales impact. UK, if you think about it, the way our business is a rig, we have a number of businesses in UK, but it's a place where technicians own their own tools. So Tools Group has a particularly strong position there. So a lot of the markets were kind of exposed in the UK, I think it might be the second or third largest market for us.

If it gets better, first of all, if the current goes positive, that's one good thing for us. And then secondly, I think, my view is, is that there hasn't been an organized areas, an organized economy, an economic or commercial angst that equals Brexit in a long time. And so you can hear it from the marketplace that people are worried about the future, what's going to happen commercially and therefore they focused more on the items that only have short paybacks, that gets resolved all that changes.

So I think they're – if you think about it as our second or third largest market, it comes back to normal I don't know the time constants to which it comes back to normal, but I have to believe it's pretty good. Pretty quick.

Gary Prestopino

Okay. Thank you. That's all.

Nick Pinchuk

Okay. Sure.

Gary Prestopino

And then, could you maybe just comment on what kind – did you see any growth in the tool storage area year-over-year? Given that you've put out a whole bunch of new products out there?

Nick Pinchuk

Yes, well the tool storage, what you want to look at is the tool storage out of the SFC and we did see growth out of the SFC, so that's the big events in this quarter. I've always say the third quarter is squarely you can't figure any – you can't extrapolate any trends out of

the third quarter is squarely, you can't figure any – you can't extrapolate any trends out of the third quarter, particularly because we had people coming back from vacations and the distributors in Europe are off for part of it, but also because we have the SFC and that creates variations in the behaviors of the franchisees, they usually wait for this and a lot of it has to do with – the success with tool storage has to do with how it came out of the SFC and it came out okay out of the SFC.

Gary Prestopino

Okay. Thank you. Thank you so much.

Nick Pinchuk

Good.

Operator

We will take our next question from David Leiker with Baird.

David Leiker

All right. Good morning everyone.

Nick Pinchuk

Good morning.

Aldo Pagliari

Hi, David.

David Leiker

Nick or Aldo, on the Tools Group, we've talked about this, but I just want to dig through this. The higher spending level is not driving revenue and that's a missing part of the equation of this story. So I guess – is the issue there that, that spending – how do you measure the effectiveness of that spending, if that's working?

Nick Pinchuk

Well, here look, I think, actually it's pretty simple. You're looking for more sales. So I think that's certainly it. So the ultimate measure is to see more sales and we did see diagnostics, this sort of – we had pretty good focus on diagnostics to the SFC, those seminars were well attended. The feedback we got, I got personally and we got generally from the people in the surveys is very good about the attendance and the roll out of the SFC to take up out of the SFC was pretty good.

Now what happens is the SFC product ends up being late in the quarter, so you can't really judge by the third, it's a very iffy thing and it rolls into the fourth quarter and so on. So it's hard to judge whether that particularly had an effect on sales or not, but that's the ultimate test. We're doing it, so sales go up, you know what I mean? We're convinced though, that, part of this has to do with the products are getting more complex and it takes unless you're very, very practiced at selling it, it eats up time.

And I've been saying for a dog's age, how much the time of a franchisee is a scarce resource, so it bumps up against our selling capacity. Actually, the motion of the market bumps up again and that's what we're trying to do, we're trying to unleash that. But sales are the basis for it.

David Leiker

Yes. So this spend I think is predominantly in the U.S. market, right?

Nick Pinchuk

Pretty much. Because – look, despite this U.S. market we think is okay, the other markets are kind of afflicted.

David Leiker

Yes. So if you look at the U.S. market, I mean low-single-digits here, I think you might've been mid-single-digit the quarter before, does that imply that spend is working the way you want it or are you trying to get sales higher?

Nick Pinchuk

We're trying to get sales higher

we're trying to get sales higher.

Aldo Pagliari

The sales were also low-single-digit in Q2.

Nick Pinchuk

Yes. They were low-single-digit, we're trying to get sales high. That's true, I mean that's the whole thing. This is a situation that we believe the market is there. We believe we have the products that can take that market. We see those products having some frictions in the way our business operates in terms of the way they sell. And so we have to make it more efficient, that's why we're spending on this. But we're pretty confident that that's going to work. And by the way, the franchisees tell us, I just had a franchisee tell me that he got training and then he conducted training for technicians. It's all about telling the technicians how to wheel these products and he sold a lot of diagnostics.

So we hear a lot of windshield surveys about this kind of approach working for us and the training having positive effect. But it hasn't played out in the numbers yet because I don't think we saw after the SFC the – we haven't got a full results there for the SFC based on calendarization

David Leiker

So let me ask you one other piece on the same topic. So the spend isn't driving the sales, is that because there is a lag between those and we're still waiting on that? Is that because of what you're doing isn't working, you need to continue to tweak it and find something else? What's your thought?

Nick Pinchuk

No, look, I think we think our – it's working better. We will continue to tweak it every quarter, we'll continue to tweak it, because this kind of thing, you need to keep making it better and better, that's the thing. But it's not because we don't think the current – we actually were very encouraged by the results – by the feedback we got after the SFC. But in terms of reporting, we got to see the sales and if we don't see the sales, we're start tweaking again and we'll probably keep tweaking anyway, like we tweaked the Rock 'n Roll Cab. All that time it was growing, it wasn't static.

from 2017, at that time it was growing, it wasn't static.

David Leiker

Okay. And then just one other item, although on the working capital you went through some of the comments as it relates sequentially, quarter-to-quarter, if you look at the year-to-date number or even year-over-year, there's about a \$100 million that went into working capital. Some of that's going to be currency, some of that's going to be acquisitions. But can you talk about what the pieces of that are and break that a part for us?

Aldo Pagliari

Sure. David, actually, you and Nick have been talking about a big piece of it. Actually, if you look at the year-over-year variance, 65% of the increase is attributable to the Snap-On Tools Group. If you look at it in the quarter, 85% of the variance is related to the Snap-On Tools Group. So one thing, we think there is more opportunities to be had. The inventory is there to try to capture those opportunities as they manifest themselves.

Second, what makes it – the order is taken to the SFC, we're well above the sales that we had in terms of the quarter. So while orders don't necessarily equals sales, we like having stronger orders coming out of the SFC and that's why we feel pretty good that the inventory we have built as a home to go to as we roll through the future quarters.

David Leiker

Okay. Thanks.

Nick Pinchuk

Sure.

Operator

We will take our next question from Bret Jordan with Jefferies.

Bret Jordan

Hey, good morning guys.

Nick Pinchuk

Good morning.

Aldo Pagliari

Hi, Bret.

Bret Jordan

Nick, I guess all those questions for you. On corporate expense and obviously controlled number this quarter, should we be thinking about sort of a lower corporate expense over time? I think you used to sort of guide to that and the number was north of 90, but is something structurally going on now?

Nick Pinchuk

I think the right ongoing pace of corporate expense, if you look at it runs between \$20 million to \$23 million per quarter, so we're under that. I hate to say the reason we're under it, because variable compensation is down significantly, actually accounts for most of the differential. So obviously, if we start to achieve the type of sales targets and you've heard us talk about and operating performance, we would expect that to return to a more normal level. And so I'm not going to give you a quarter-by-quarter estimate. We still hold true to our long-term run rates, that corporate would be in the \$90 million to \$95 million range would be more appropriate. This year we just hit our own targets.

Bret Jordan

Okay. And then on – question on sort of follow-up question on the inventory, the working capital question. I think in the prepared remarks you talked about it being higher for – anticipate a critical industry demand, but then on that last response you were talking about a fair amount of the working capital growth being tools related. Do you have visibility on this critical industry ordering that the inventory that you're building is going to get sold out? Is there sort of a build of inventory in advance of the sale or is this sort of more speculative inventory growth?

Nick Pinchuk

Actually, on the critical industry side it's less speculative, it's actually more made to order the problem that you have, I guess, you can say it here, the fact that we manage – I don't know if it's a happy problem or a difficult problem, hand tool volume in the Tools Group has never been higher. It's putting a lot of demand for all the resources that we have in our manufacturing plants that are dedicated to hand tools.

In addition, the projects that are very specific that are in the hands of our industrial division that serves a critical industries have a lot of hand tool content. It's a nature of the timing of how these projects unfold, many times you've bid them as much as a year earlier when they're finally awarded and get funding, sometimes it takes quarters of lag. So what you have is you've doubled down on demand at the same time coming out of our hand tool factories. So to answer your question, on the industrial side, it's not speculative.

You can always argue that on the tool side, while we try to control the pace of demand to some extent with our product offerings and our promotions and what we intend to offer, it is a little bit more short-term in that will live hand to mouth in the Tools Group, right, in terms of the order book. On the critical industry side, there is more of a backlog, so we know what our customers want, we have the Tools Group that actually has to supply to both, but the Industrial Group itself doesn't have factories. The Tools Group is the key supplier to the Industrial Group.

Bret Jordan

Yes. Okay. Thank you.

Operator

We will take our next question from David MacGregor with Longbow Research.

David MacGregor

Yes, good morning everyone. Just to hang up on the inventory discussion while we're on that topic, how does this 2.6 times turnover compared with targeted levels? What is – how should we be thinking about kind of a normalized number there?

Aldo Pagliari

Well, I think the question is more like this, is that, I don't think, we kind of look at ourselves to make sure that we have the appropriate inventory in place, and it's not so much a target. I wouldn't say the target is an independent variable. What we target is the return on net operating assets because one of the situations where we keep expanding our product offerings, so that keeps adding to inventory. Our principal, primary drive is the RONA bit calculation as opposed to the inventory turn calculation.

David MacGregor

Okay. Conspicuous – I guess conspicuous is the absence from the discussion of the Tools segment this quarter was RCI. And I guess the question is do you feel you've kind of approached the limits of what's achievable in the near-term in terms of margin there?

Nick Pinchuk

No. I think I said in – you can't cover everything in these calls. So I – the thing is it's like this is that generally, RCI is operating pretty well, but this is a time of periodic challenge. There are a lot of things going on. For example, you have currency. You have some of these higher costs in investing in the Tools Group. Both of those are in great factor in the Tools Group. On the other end and as well, you do have some material costs floating through. Normally we don't mention material costs, but they're not matched with such other challenges. So RCI didn't really offset those, so we didn't talk about them. RCI was a counterbalance though to some of them.

I mean if you look at the Tools Group, one of the things that's kind of interesting of the Tools Group, if you look at the gross margin, the gross margin is down 20 basis points, again, 60 basis points of unfavorable foreign currency. So at the gross margin level, you can see, if you just hone in on that, you can see the effects of RCI.

David MacGregor

On the operating expenses, I guess you talked about higher field support investments. I guess a question for Aldo, how long will it take these investments to leverage in the margins?

Aldo DeSilva

Aldo Fagnani

Well, it's a good question. I don't want to give you a quarter-by-quarter guidance. To kind of indirectly answer this or I directly answered it, I guess, earlier on, we believe in what we're doing. It doesn't mean you meet with immediate success. One key differentiator, David, for Snap-on, as you well know, is we're up close and personal. That's what we're all about. That differentiates us from the crowd.

In terms of our franchisees, that means to have to be on-site delivering great expertise to help customers solve problems out of the variety of 42,000 SKUs that they represent in the backdrop, which means we have to make sure that our guys are trained to be effective in delivering that message and do it in a very narrow time constant. They only have so many minutes that they can spend. So we find there's better ways to do it, and that's what we've been embracing.

We accentuated that at the SFC, and we are very pleased that we had, I think, well over 1,200 attendees at our – as an example, our diagnostic training session, which tends to be a complicated product. So we believe the franchisees recognize the importance of ongoing training for themselves and when they have assistance, their teams, and we're going to continue to reinforce that and we're not going to abandon our approach to differentiate Snap-on on that basis. So I hope we get the returns very quickly. I can't guarantee that and we'll continue to invest in that channel though to make sure that they are par excellence as opposed to the competition.

Nick Pinchuk

So we see it as a kind of strategic advantage. One of the things about it, cars are getting more complex. The way to fix them are with these very elaborate products, but the elaborate products cannot actually be effectively wielded without face to face guidance and training and coaching that our franchisees are well positioned to do. The problem is if they're not really good at it, it'll eat up a lot of their time. That's why we're so high on this training and focused on it. Take advantage of that strategic...

David MacGregor

Thanks for that detail. Last question for me is just we keep talking about organic growth in the Tool segment and it's been a real challenge and frustrating for you, I'm sure. I guess I'm trying to understand some of the structural underpinnings behind the situation. I wonder if you could just talk about the extent to which you feel franchisee attrition is a headwind in achieving that 4% goal.

Nick Pinchuk

Okay. A lot of – there are a lot of ways to think about this. I mean, franchisee attrition can be a headwind. I mean, certainly to the extent you have retirement, where the people who have been in place for a long time, sometimes it's hard to – to replace them. So certainly in one point in time if you have more turn-ins, even if you – and like this quarter, we basically had turn-ins and we didn't lose any franchisees and we filled up those routes immediately, but there is a startup period. So that'll set you back a little bit.

But on the other hand, in many cases when you put a fresh pair of hands in, an enthusiastic fresh pair of hands that's starting out, they are smoking and the numbers go up. So I think you kind of balance those two. I'm not sure you can say for sure, it might be a temporal situation for a short period of time, but I kind of think when we replace people it's okay.

David MacGregor

Thanks, guys.

Nick Pinchuk

Sure.

Operator

We'll take our next question from Curtis Nagle with Bank of America.

Curtis Nagle

Good morning, gentlemen. Thanks very much taking the call.

Aldo Pagliari

Good morning, Curt.

Curtis Nagle

How are you guys doing?

Aldo Pagliari

We're surviving, buddy.

Curtis Nagle

Okay, good. So, yes, just I guess two quick ones on capital. It looks like CapEx, I think kicked up a little bit. Just curious what that's accounted for.

Nick Pinchuk

Yes, new product. I mean, the thing is that we're expanding products. So you heard, I think we both mentioned that hand tools are pretty strong in the quarter, and so you're expanding that. And all that new product I went through in my discussion that is often backed up by factory positioning, but particularly the hand tool business, which is very highly integrated. So that's what's driving that a lot.

And then also we invest because we turn out so many new products, we tend to invest in the ability to just to design those products and to figure out how we can prototype faster and so on, things like direct laser metal sintering and 3D and so on. And Mitchell 1, we're expanding in Mitchell 1, we're putting them in a bigger building because they're so profitable and has done so well. Mitchell 1 has been – if you've been listening to the calls, have been every quarter doing very well and they're a high profitability company, so we want to enable them as much as possible.

Curtis Nagle

Okay, understood. And then, yes, just kind of on a related topic, in terms of executions for buybacks. Looks like it's a good bit below last year, at least up through 3Q. So I guess, how should we think about that? Perhaps you'll have a pickup in 4Q? Or is there something else that's holding you back at the moment?

something else that's holding you back at the moment.

Aldo Pagliari

Actually, I'll answer that, Curtis. Actually, it's a little bit more similar than you realize. If you look back in Q3, there was a lot of share option exercise that occurred in the quarter. So if you look at the net share repurchase, it actually is very similar. It was \$58 million this year versus \$59.9 million last year. So actually similar in that regard.

Having said that, we look at share opportunities in terms of repurchase effort, we look at where the stocks are relative to the market, what is the backdrop, how much volatility is in the marketplace and things of that nature. So it's hard to say with exactitude what one's going to buy in any quarter, but it was an opportunity to buy in the quarter and we did. And if you look on a trailing 12-month basis, we've been on pace to buy a little over 2% of the outstanding shares of the company. So it's something that we look at each and every quarter and talk to the Board about what we should devote to this activity and we have authorization to be flexible. So at this point in time we're in pretty good shape.

Curtis Nagle

Okay. Thanks very much.

Operator

We will take our next question from Christopher Glynn with Oppenheimer.

Christopher Glynn

Yes, good morning. Thanks. Wondering where you might be seeing macro impacts of the well known economic slowdown there – out there. I know many of your markets sync to their own tune to a little bit of a degree, but you are diversified. So wondering where you're seeing some of those impacts.

Nick Pinchuk

Say that again. Where you're seeing the impacts of economics on the markets?

Christopher Glynn

The slower macro there, with the caveat that I know some of your access to markets operate a little independently of short-term macro fluctuations. Just wondering...

Nick Pinchuk

Yes, look, I think, we – okay, I got it. I think we think the U.S. is pretty good. I think U.S. business is – if you look at the macros in the U.S. in terms of technician wages, went up 3.6% year-over-year. And the investment – the nominal investment in the car – the real investment in the car repair went up 2.5%, so – and the miles driven went up. So I think that's pretty positive. And we kind of feel that when we do the windshield surveys out in the marketplace. So we think that's a good business.

I mean, the industrial business in the U.S. was okay for us in the quarter. It again was very good. I think when you talk to people in industrial and the bigger companies, they're a little more muted in their views of the world, but still we think that's okay. I think Europe, the UK and Germany were particularly more difficult. I don't know, I think that's all Brexit related though. Both of those are related in terms of Brexit.

In Asia-Pacific, China is a kind of, I would say squirrely market these days. And it was kind of flattish this quarter, maybe down just a little bit, but you see China having a little bit more difficulties in terms of the – I suppose in psychology of commercial advancement these days. So I think you see that. I think Australia; we've seen Australia coming off the bubble I think commodity related and so on, the latest commodity downturn.

Christopher Glynn

Okay. And on the SOT margins...

Nick Pinchuk

Yes.

Christopher Glynn

As it's been sort of a flattish or below target for some times as just addressed, I'm wondering if that your – there's maybe a structural reset in the margins we should

anticipate as you kind of create a cost structure to see the next succession of higher organic compounding, and maybe the channel investment you're putting in now is maybe a step in that direction. Just curious wanted to float that concept by you.

Nick Pinchuk

Well, I think, look – I think, Chris, the gross margins now okay, generally. I mean, there's a lot of variation. Like I said, those margins has been okay and we're investing a little bit in the business, and so I do believe we're going to stay at that level for some time. Even if sales come back, the plan is we're investing in that, we're enabling the franchisees and the sales go up. As a percent of sales, they don't – you kind of fall away and of course profitability goes up. That's the idea. I don't think we're looking to – that is an ad which we're going to keep for awhile, but we are – that's what we think is going to work.

Christopher Glynn

So you're not working out a fundamental resizing of the SG&A side, necessarily?

Nick Pinchuk

No, no, no, no, because we think we know the problem.

Christopher Glynn

Okay, great. Thank you.

Nick Pinchuk

Yes.

Operator

And we'll take our next question from Scott Stember with CL King.

Scott Stember

Good morning, and thanks for taking my questions.

Aldo Pagliari

Hi, Scott.

Scott Stember

Aldo, you made a comment about within tools that the hand tool demand was – has never been higher. Can you maybe just give us some of the sub-segments within Tools how hand tools ditch tool storage, power tools and all that kind of, and diagnostics?

Aldo Pagliari

Sure. Hand tools is and has been the biggest category for the Snap-on Tools Group. And again, it's had a very robust year. By design to some extent, I mean, because we've introduced a lot of new products in that area. We've put together a lot of nice promotional packages in that area. It's resonated with the franchisees and seems to be resonating in the uptake of their customer base. So again hand tools has not dissipated whatsoever even with the advent of more complexity in cars.

Next important product lines, typically is the tool storage and diagnostics. Tool storage tends to be right up there. And this quarter diagnostics was actually better. Diagnostics did quite well off the Tools Group. And again, you've been hearing us talk a little bit about emphasis. So any quarter, Scott, you get variation depending on what the team is emphasizing. In this particular quarter, diagnostics was a little bit more accentuated; training that we've talked about already and things of that nature.

And power tools is more an issue of timing. Power tools was not as big in the quarter for sales to the Tools Group, but the order book for power tools looks pretty good. And Nick talked that like – some of the new product features on the half-inch impact and we expect that's going to have pretty good fourth quarter even though we don't give guidance kind of in the future quarters. So that's kind of the lay of the land.

Nick Pinchuk

See, the thing about hand tools is it's been up strong for several quarters. But that's what leads to the Aldo's comments that the demand is very, very robust because that's been pretty steady, higher and higher. It's going fairly well because of the expansive things like

the FDX, the Flank Drive Extra, spreading out over the wrenches, get people to say, oh, I need a new set of wrenches because this is the new wrenching system and it's much more effective. So they sign up for that. So the hand tool product line has been particularly robust and has resonated with customers and it's been for several quarters. That's what leads to the question of the factories.

Scott Stember

Yes. And just – could you just give us some commentary up mid singles, high singles and maybe for a couple of the other sub-segments as well, some actual numbers?

Aldo Pagliari

You're talking about Tools Group or the other groups now?

Scott Stember

Yes, within Tools Group, maybe how the hand tool was up mid singles, high singles?

Aldo Pagliari

Our hand tools was up mid-single digits and diagnostics is up strong, even stronger than that. Power tools as I said, it was down for them in the quarter and tool storage was more reflective of timing down a bit, but again, the order book for tool storage looked pretty good at the show. So again, orders don't necessarily equal sales, but a nice order book coming out of the SFC related to tool storage.

Nick Pinchuk

And in the third quarter, the general view was more or less what happens in the orders out of the SFC. And generally, they were mostly – in fact, I think they were, all those categories we talked about were up mid – lower mid-single digits. So it came out relatively strong. I think the SFC itself was up mid-single digit.

Scott Stember

All right. And within RS&I, could you maybe just quantify how sales work in your company versus outside of the Tool Group, meaning to outside whether it was a dealerships, just

quantify what the numbers were?

Nick Pinchuk

Wow. I think that the intercompany sales is principally the sales of diagnostics. There's some equipment that sells through there too. I think the diagnostics were up reasonably strong in the quarter, reasonably strong in the quarter. They get sold not exclusively, but principally to the Tools Group and they were up I think mid-single digits in a quarter, so we had that. And then, Aldo already told you that the sales by the Tools Group was positive, so that's a nice balance.

And then equipment I think was flat to down, a little bit down in the quarter for the Tools Group. And those were the primary intercompany sales. The rest of the stuff, like I said, you had actually, the way you think about RS&I is, is the sales to the OEM businesses generally tends to be a little bit low margin – little lower margin, lower SG&A. That was up about double digits I think really well. The sales to the independent repair shops with the software diagnostics were also up mid single-digit. So – and the equipment business was down a little bit driven by weakness in Europe.

Scott Stember

Got it. And lastly on FX, last quarter, last couple of quarters you gave – the earnings impact was to the bottom line. What was it this quarter? And also – go ahead, I'm sorry.

Nick Pinchuk

It was about \$0.06.

Aldo Pagliari

Yes. Previous quarter, Scott, it was \$0.08 of bad news. This quarter it got a little better at \$0.06 and I expect that trend is kind of what I'd look at in Q4. Again, currencies never stay where they're at. But if they do, it'll be slightly less headwind than the bottom line and Q4 currencies stay where they're at the end of the quarter here.

Scott Stember

Got it. That's all I have. Thanks, again.

Nick Pinchuk

Thank you.

Operator

And with no additional questions, I would like to turn the call back to Sara Verbsky, for any additional or closing remarks.

Sara Verbsky

Thank you all for joining us today. A replay of this call will be available shortly on [snapon.com](https://www.snapon.com). As always, we appreciate your interest in Snap-on. Good day.

Operator

Ladies and gentlemen, this concludes today's call and we thank you for your participation. You may now disconnect.