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Illinois Tool Works Inc. (ITW) CEO Scott Santi on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-25-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $1.9722 beats by $0.02 | Revenue of $3.48B (-3.71% Y/Y) misses by $-73.59M

Earning Call Audio

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Illinois Tool Works Inc. (NYSE:ITW) Q3 2019 Earnings Conference Call October 25, 2019 10:00 AM ET

Company Representatives

Scott Santi - Chairman, Chief Executive Officer

Michael Larsen - Senior Vice President, Chief Financial Officer

Karen Fletcher - Vice President of Investor Relations

Conference Call Participants

Ann Duignan - J.P. Morgan

John Inch - Gordon Haskett

Jamie Cook - Credit Suisse

Andy Casey - Wells Fargo Securities

David Raso - Evercore ISI

Joseph Ritchie - Goldman Sachs

Stephen Volkmann - Jefferies

Vlad Bystricky - Citi

Nigel Coe - Wolfe Research

Mig Dobre - Baird

Walter Liptak - Seaport Global

Josh Pokrzywinski - Morgan Stanley

Steven Fisher - UBS

Nathan Jones - Stifel

Operator

Good morning. My name is Julianne and I will be your conference operator today. At this time I would like to welcome everyone to the conference call.

[Operator Instructions] Thank you. Karen Fletcher, Vice President of Investor Relations, you may begin your conference.

Karen Fletcher

Okay, thank you Julianne. Good morning and welcome to ITW's Third Quarter 2019 Conference Call. I'm joined by our Chairman and CEO, Scott Santi; and Senior Vice President and CFO, Michael Larsen.

During today's call, we'll discuss third quarter financial results and provide an update on our 2019 full year outlook.

Slide two is a reminder that this presentation contains our financial forecast for the remainder of 2019, as well as other forward-looking statements identified on this slide. We refer you to the company's 2018 Form 10-K for more details about important risks that could cause actual results to differ materially from our expectations.

Please note that this presentation uses certain non-GAAP measures, and a reconciliation of those measures to the most comparable GAAP measures is contained in the press release.

Please turn to slide three. Today we are announcing the date and location for ITW's next Investor Day. We hope you can join us on Friday, March 13 in Fort Worth, Texas at which time will provide an update on our long term strategy and offer a tour of our Traulsen, Refrigeration Plant site and the opportunity to see the ITW business model in action. Today's announcement is strictly a save-the-date alert and will provide more details on the event, including how to sign up for it when the date gets closer.

So now we’ll move on to slide four, and it’s my pleasure to turn the call over to our Chairman and CEO, Scott Santi.

Scott Santi

Thank you, Karen and good morning. While slowing CapEx investment and declines in auto production in North America and China impacted the demand environment across a broad cross section of our portfolio, we delivered another solid quarter with excellent operational execution.

Despite the macro challenges, we delivered earnings per share growth, operating margin of 25%, and a 12% increase in free cash flow. Despite lower volumes, we improved operating margin 40 basis points year-over-year with enterprise initiatives contributing 120 basis points and increased after-tax return on invested capital by 120 basis points to more than 29%.

Looking ahead at the balance of the year, based on demand rates and our margin performance exiting Q3, we are maintaining our full year 2019 EPS guidance range of $7.55 to $7.85, while acknowledging that the combination of near-term macro uncertainties and the lingering strike at General Motors likely skews the probabilities of potential outcomes toward the lower end of the range.

Moving forward, we continue to focus on executing at a high level on the things that are within our control in the context of the near term macro uncertainties, while remaining fully invested in driving progress on a Finish-the-Job enterprise ready strategy agenda, and on positioning the company to deliver on our 2023 enterprise performance goals.

Our demonstrated ability to deliver strong results across a range of economic scenarios while continuing to make consistent progress towards our long-term full potential performance is a direct result of the combination of the performance power and resilience of the ITW business model and a dedicated team of ITW professionals around the world who leverage it to serve our customers and execute our strategy with excellence day-in and day-out.

With that, I'll now turn the call over to Michael for some more details on our Q3 results. Michael?

Michael Larsen

Thanks, Scott, and good morning everyone. In the third quarter, organic revenue declined 1.7% year-over-year as demand slowed modestly across our portfolio. This quarter had one extra shipping day, so on the same-day basis organic revenue was down 3.2% versus the 2.8% decline in Q2. Product Line Simplification was 60 basis points.

By geography, North America was down 2% and International was down 1%. Europe declined 2%, while Asia Pacific was up 2%. On a positive note, organic growth in China was plus 7%.

Our execution on the elements within our control was strong as we expanded operating margins by 40 basis points to 25% with strong contributions from enterprise initiatives and positive price cost. Our Q3 decremental margin was 15%.

GAAP EPS of $2.04 benefited from the fact that we filed our federal tax return and reduced our estimated tax liability for tax year 2018 by $21 million, which contributed $0.07 of EPS in the quarter.

On a year-over-year basis the $2.04 GAAP EPS number included $0.05 of unfavorable foreign currency translation impact, which was offset by a $0.05 benefit from our lower Q3 tax rate of 21.6% as compared to 23.7% in the prior year.

As expected free cash flow was strong at $830 million, an increase of 12% with the conversion of 126%. We repurchased $375 million out of our shares and raised our annual dividend by 7%. Overall, excellent operational execution and solid financial performance despite some external challenges.

Let’s move to slide five and operating margin. As you can see from the chart, operating margin improved again this quarter with enterprise initiatives contributing 120 basis points, which was the highest level since 2017. It is worth noting that the enterprise initiatives impact is broad based across all seven segments ranging from 80 basis to 190 basis points, and we're seeing the benefits of the accelerated restructuring activities we initiated earlier in the year.

Price remains solid and well ahead of raw material inflation on a dollar basis. In addition, raw material cost pressures eased again this quarter, and price/cost margin impact was positive for the first time since 2016. Volume leverage was unfavorable 40 basis points, and other was 60 basis points of headwind, about half of which was from normal, annual inflation on wages and salaries, coupled with some one-time items. Restructuring expense was equal to what we spent in the third quarter 2018. So, in summary, strong operating margin performance again this quarter.

Turning to slide six for details on segment performance. The table on the left provides some color on organic grow. As you can see, on an equal day basis, we were down 3% in Q3, which was essentially the same decline as in Q2.

Like Q2, we experienced lower levels of demand in some of the CapEx related offerings. You can see the impact in Food Equipment, Test & Measurement, and Electronics, both with growth rates 4 points lower than last quarter. However, in both cases, underlying order rates were pretty good. Automotive OEM was down less in Q3, largely due to the benefit from an easier comparison year-over-year, and the Welding and the remaining three segments were all pretty stable.

Now let's move to individual segment results starting with Automotive OEM. Organic revenue was down 2%, as the GM strike reduced revenues by approximately 1 percentage point. In addition, we had 100 basis points of PLS impact. North America was down 6%, Europe was essentially flat, and China organic growth was 7% in a market where builds were down significantly. Margins of 22.1% increase 60 basis points year-over-year.

Moving on to slide seven. Food Equipment organic revenue was down 1% despite strong performance in our service business, which was up 3%. In North America, demand for equipment was a little slower in retail, restaurants were about flat, and we continue to experience growth on the institutional side despite a pretty difficult comparison.

Operating margin expanded 90 basis points to 27.5% with enterprise initiatives, the main contributor. Test & Measurement and Electronics was a little softer this quarter as organic revenue declined 3%. Test and Measurement was down 4%. Excluding sales to semiconductor equipment manufacturers, organic growth would have been up 1%. Electronics was down 3%, mostly driven by softness in electronic assembly. Operating margin nevertheless expanded 90 basis points to 25.6% with enterprise initiatives also a main driver here.

Turning to slide eight. Welding organic revenue declined 2% against the tough comparison of 10% growth last year. In North American the equipment side was down 4%, but against the comp of more than 10% growth last year. North America consumables were up 4%, which continues to point to pretty good underlying Welding activity at our customers. International is now 3% and operating margin was 28.2%.

Polymers & Fluids organic growth was up 3% with Polymers up 7% against the comparison of down 3% last year. Automotive aftermarket was up 2% and Fluids was down 1%. Operating margin was up 200 basis points, driven primarily by enterprise initiative.

Moving to slide nine, construction organic revenue was down 1% with continued risk in Australia and New Zealand which was down 4%. Europe was up 1% and North America was essentially flat with residential remodel however up 4%, offset by lower demand in commercial construction.

In Specialty, organic revenue was down 5% and similar to Q2 the main drivers were 100 basis points of the PLS impact and the relative performance of the businesses we've identified as potential divestitures. These potential divestitures reduce organic growth for the segment by about a point and half; in other words core specialty was down 3.5%. By geography international was down 5% and North America was down 4%.

Let's talk about full year guidance on slide 10. Based on demand rates and our margin performance exiting Q3, we are maintaining our full year 2019 EPS guidance range of $7.55 to $7.85, while acknowledging as Scott said, that the combination of near term macro uncertainty and the lingering strike at General Motors likely skews the probabilities of potential outcomes towards the lower end of the range.

While the Q3 discrete tax items that I described earlier, lowers our full year tax rate to approximately 24%. This benefit is essentially offset by incremental foreign currency headwind that has crept in since we updated our full year guidance as of the end of Q2.

We expect that operating margin for the full year would be approximately 24%, which is down slightly from our previous guidance as a result of higher accelerated restructuring expense and the impact of slightly lower volume. It is worth noting that given the environment, we now expect incremental accelerated restructuring expenses in Q4 that will represent a headwind of approximately $0.03 year-over-year.

Our cash performance has been strong all year and we expect that our full year conversion rate will be well ahead of net income. Our plan in terms of share repurchases remains unchanged and we are on track to repurchase approximately 1.5 billion of our own shares this year.

Now for a quick update on our portfolio management activities. Overall our various divestiture processes are on track. As a reminder, we're looking to divest certain businesses with revenues totaling up to $1 billion and are targeting to complete this effort by year end 2020 with about half of the divestitures in 2019.

The positive impact includes about 50 basis point improvement in our organic growth rate and approximately 100 basis points of margin improvement. Not counting potential gains on sale and the EPS dilution will be offset by incremental sherry purchases and we will continue to provide you with updates on our regular earnings calls.

Finally as a result of moving our annual Investor Day to March, we will now provide 2020 full year guidance, part of our January 2020 earnings call.

With that, Karen I'll turn it back to you.

Karen Fletcher

Okay, thanks Michael. Julianne, please open up the lines for questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Your first question comes from Ann Duignan from J.P. Morgan. Your line is open.

Ann Duignan

Hi, good morning everyone.

Scott Santi

Good morning!

Ann Duignan

Good morning. Maybe we could start out with more color on end markets and what you saw as you went through the quarter in terms of cadence of sales or cadence of orders by segment. If you don't mind, just some color as to what's going on beyond the General Motors strike? I appreciate it.

Scott Santi

Yeah, sure Ann. So I think there's really nothing yet unusual on a monthly basis as we went through the quarter. I think as we talked about in the script, we did see a modest slowdown, particularly on the CapEx side here in Q3 similar to what we saw in Q2, and you saw it show up to some extent in Food Equipment as well as in Test and Measurement where the growth rates were lower in Q3 relative to Q2 on a year-over-year basis.

You know that said, I also think it was worth pointing out that when we look at the underlying activity in these businesses and the order rates, they are actually looking pretty good heading into Q4, so a little bit of a mixed bag here.

I'd say automotive looks like on a year-over-year basis, certainly the Q3 organic growth rate was better than Q2. Part of that is an easier comparison, and then obviously we talked about the impact of the GM strike here in Q3, so – and the remaining segments, pretty stable, you know Welding, Construction, and Specialty.

Ann Duignan

And just a follow-up on maybe some color on the Welding side consumables versus equipment. I mean, I think you had flagged back in Q2 as the CapEx side slowing, but the consumable side still strong, and I think in your comments you reiterated that. Could you just update us on if there was any change in that industry?

Scott Santi

Yeah, so I was just talking about North America which is really 80% of our business. You know, we did see some softness on the equipment side, down 4%, but keep in mind the comp from last year, equipment was up 11% in Q3 last year. Consumables, up 4% – I think we were up 8% in consumables here in the second quarter. So, a little bit of – maybe a little bit of a slow down on the consumables side, but overall North America down 1%, and I think we've said Welding is pretty stable here in Q3 similar to what we saw maybe in the second quarter.

Ann Duignan

Okay, I'll leave it there in the interest of time. I appreciate the color. Thanks.

Scott Santi

Thank you, Ann.

Operator

Your next question comes from John Inch from Gordon Haskett. Your line is open.

John Inch

Yeah, thank you. Good morning everybody.

Scott Santi

Good morning.

John Inch

Good morning. The GM strike, is that – are you guys assuming that the GM strike does not get resolved in the fourth quarter as part of your guidance. It may not move the needle perhaps, but – and then when it actually ends Michael, that 1% drag, does it flip to a 1% contribution or because there has to be inventory fill back at the company, right in terms of working process, does that actually go up higher than the 1%. How are you thinking about it?

Scott Santi

Well, I would say that all the scenarios, all the potential scenarios from it gets settled. I guess next week with the Board [ph], all the way through that never gets settled through the quarter are embedded in our guidance range. You know there is – we have really no purpose or advantage in trying to make a particular bet. We are obviously not involved in the process, but have incorporated all the – you know sort of the most optimistic and the most pessimistic scenarios in our guidance range for the balance of the year and essentially that's how we are approaching it. And since you asked Michael, and I'll give you a little color in terms of the potential impact on the organic growth of the company.

Michael Larsen

Yeah, I think here in Q4, as Scott said kind of best case at this point is, we start back up next week. So we've already lost a month, which is almost a full point of organic growth at the ITW level, about 3 percentage points of impact in the auto segment alone, so that's essentially done at this point. And then if you can you kind of, as Scott said, if things do not get resolved at all this quarter, which is maybe the worst case scenario, we would lose another [multiple speakers].

Scott Santi

That is the worst case scenario.

Michael Larsen

Which is the worst case scenario. You know we’d lose another 2 points of organic growth here. So those things are kind of all embedded in what we're talking about today, and I think it's part of the elements that you know skew our view in terms of the guidance range towards the lower end as we talked about it.

John Inch

Okay. So in other words, if the worst case scenario GM doesn't get resolved until Jan 1, the low end of your range for the year, the $7.55 still captures that, that's what you're saying?

Michael Larsen

Yes. I mean I think, obviously we don’t want to get into customer profitability, but in terms of you know EPS, we're talking about pennies of impact here.

John Inch

No, that's fine. Just for my follow up, Scott I remember historically how your enterprise initiatives and PLS, you were fairly adamant this was going to lead to kind of a structural elevation in ITW's organic growth, and you guys have been at this obviously for years; and it's been very, very successful. Here we are in the third quarter and PLS is kind of sort of at the same cadence, right, 60 basis points; it was 70 last quarter; enterprise initiatives is actually accelerating.

I'm just wondering, I mean presumably you would've gone after kind of the lower-hanging PLS fruit. Is there a risk that as we keep this PLS cadence off that, you know the future for with respect to organic growth and what you had thought would be the benefits from this somehow gets impacted because this PLS just doesn't abate if that makes any sense, and maybe growth has an impact down the road.

Scott Santi

Well, I think the – I don't see it as a risk. I think really what we are seeing play out is that the PLS rate has definitely come down over this, you know the period that we've been implementing it.

John Inch

Right.

Scott Santi

If you remember back to the front end of the implementation of the strategy, it was running 1 point to 1.5 points.

You know, we feel like on an ongoing basis just embedded in how we operate the business model normalized, I think we even talked about this at last Investor Day; normalized PLS should be 30 to 40 bps, so at 60 I don't think we are too far from, you know we're not – we're certainly demonstrating the movement through that process certainly, and as you suggested, the low hanging fruit we dealt with a few years ago, but there's certainly some fine tuning going on.

A lot of that in those businesses that we're still working on, getting position to grow, we'll give you an update at the Investor Day in terms of how we're tracking on the rate of growing versus not growing divisions, but I assure you we are making solid progress on that front, and we'll as I said, give you a fulsome updates in March, on Friday the 13th.

John Inch

Yes, Friday the 13th. So you're feeling good about the prospective core growth once – as a result of I guess the PLS and EI, which I presume we're going to see more of once we get rid of these, you know these companies still slated for divestiture.

Scott Santi

Yeah, there is no question. I'm not – you know the macro environment certainly right now would offset some of the online [ph] progress, but we are on it from the standpoint of the qualitative steps we need to take to accelerate organic growth. That has continued unabated through this process. It's certainly a little more difficult to see in terms of growth rate, the yield on all that effort given the environment right now, but you know we have – I assure you we are making really solid progress and it remains the number one focus of everything we're doing.

John Inch

Many thanks.

Scott Santi

You bet.

Michael Larsen

Thanks.

Operator

Your next question comes from Jamie Cook from Credit Suisse. Your line is open.

Jamie Cook

Good morning. The margin performance I guess, if you think about the second quarter and the third quarter, I guess even in first quarter you faced I guess some more challenging organic growth that's been fairly depressed. And then if you think about, you know the margin performance in the fourth quarter and while it's good, it's still implying sort of you know more of a step function down and the inability to I guess keep the margins up year-over-year I guess which is expected, but to some degree can you just provide some context on the degradation in Q4 margins and just what that implies for 2020 in terms of how we think about detrimental margins for Q2, Q3 elevated more so because the price cost. I'm just trying to understand the step function change there.

And then just my second question – I guess my second question is we all debate, you know whether how this market plays out in terms of sort of mid-cycle slowdown versus you know more challenging concerns, recessions and how you guys are familiar managing your business. Thank you.

Michael Larsen

Why don't I take the easy one, which is the first part, then maybe we'll take a stab together on the second piece.

I mean I think we've tweaked our full year margin guidance as you noticed, really to account for two things. One is that just given the demand environment that we're in, we made a decision to further accelerate some restructuring projects and so we are going to be spending more on restructuring for the full year. And these are really projects that were in the pipeline for next year and so we've pulled them forward into this year, so that's a portion of it.

And then the other piece is really you know we talked about GM impact and just kind of the macro environment and the potential impact on volume leverage, so really those two things combined.

I will tell you that at the same time when I look at the – you know we'll give you kind of a squiggle, 24%. I mean we're really talking about decimal points here, so I wouldn't read too much into, you know certainly into the implications for next year. Our ability to continue to expand margins, nothing has changed from that perspective.

So hopefully that makes you feel a little bit better about the margin assumptions here and then the second question I think was really in terms of how things play out from here, from a macro standpoint and…

Scott Santi

You're looking at me.

Michael Larsen

I'm looking at Scott here for some wisdom.

Scott Santi

Well, I guess I don't want this to be interpreted wrong, but I have none. I think our view, you know fundamentally in terms of how we operate the company is we are going to operate, we are going to react and we are going to operate to the best of our ability and whatever the external environment throws our way. I think we've built – spent six or seven years now building a highly competitive, very effective company that now has the kind of margin cushion underneath it that allows us to react to whatever the world throws at us.

I think you're all well aware of some of the issues right now and that they relate largely to a lot of uncertainty that's out in the environment for reasons that you are I'm sure all well aware of.

I think whatever – you know however that gets resolved, this company is well positioned to operate at a very high level on an absolute and a relative basis in that environment and given some of what we've talked about historically in terms of flexible cost structure, in terms of margin and profitability that we will continue to focus on operating the company in the most appropriate way for whatever the environment is that we find ourselves. Personally I'm optimistic, but who knows.

Jamie Cook

Okay, thanks. I'll let someone else get in.

Operator

Your next question comes from Andy Casey from Wells Fargo Securities, your line is open.

Andy Casey

Thanks a lot. Good morning!

Scott Santi

Good morning.

Andy Casey

Within welding, could you provide a little bit more color in the U.S.? did you see any significant differences in performance by main market?

Scott Santi

So not really Andy. It was pretty similar in North America to what we saw in Q2, I think characterized a little by some stability is maybe a way to describe it. I think if you look at you know the industrial businesses, down and low single digits, so that's more on the heavy equipment side.

The commercial business flat, maybe down a point or so and an underlying that like I said so the equipment side down four, offset by consumables up four, so we end up basically flat. Maybe I'll give you one more data point here. You know the oil and gas side was actually slightly positive, not a big part of the business in North America, but up mid-single digits in Q3, so – but really a stable quarter in terms of welding.

Andy Casey

Okay, thank you. And then when you look forward in the Q4, you called out that $0.03 of accelerative restructuring. Is that concentrated in any few segments or is that kind of similar to what we've been seeing the placement during the year.

Scott Santi

Yeah, it's very similar. I mean if you look at, there’s a schedule in the appendix of the press release that lays out kind of the – this is pretty broad based and you know as I said, I can give some points out. These are projects that were planned all along for 2020 and we're going to try to accelerate some of those into the Q4 just as a result of this, kind of the demand environment that we're seeing.

Andy Casey

But they are related much more directly to enterprise initiatives than…

Scott Santi

That is correct. I think if you want to make a distinction, I think the first half of this year there was a focus certainly around acquisition integration on the automotive side. We accelerated some projects there just give the environment that in hindsight turned out to be you know a good decision and you know this time around it's more enterprise initiative 80/20 related projects that were you know scheduled for 2020 that we're going to pull forward into 2019.

Andy Casey

Okay, great. Thank you very much.

Scott Santi

Sure.

Operator

Your next question comes from David Raso from Evercore ISI. Your line is open.

David Raso

Hi, good morning.

Scott Santi

Good morning.

David Raso

A quick clarification on the fourth quarter of the margin. With the implied sales and the implied EPS, which is about $1.94 or so to hit your mid-point, it does seem to require the operating margin to be you know nearly 25%, call it 24.8%, 24.9%, something like that. So are we saying there's a step down in the margins in the fourth quarter and if so, is the fourth quarter helped by below the line items to hit the EPS? I'm just trying to level, is that the fourth quarter view.

Michael Larsen

Yes, so this is a little tricky Dave, because we don't give Q4 guidance, we're giving you a full year number. What I will tell you is, as you go back and look at historical margins, typically take a step down here in Q4 relative to Q3, like I said, here we talked about restructuring, we talked about lower volume, you could model what the impact might be from that, and then there's no – we're not counting on any one time item one way or another in terms of the fourth quarter. So hopefully that's helpful without giving you specific guidance for the quarter.

David Raso

I appreciate that, but obviously if you take the mid-point you can't have a margin that's like 24.2% or 24.3% or whatever it may be and still hit your EPS number, unless you do get help below the line. So there's a little bit of a mismatch in the numbers and we can discuss offline.

The inventory management I thought was pretty good during the quarter. That's a first time in a few years your inventory performed better year-over-year than your sales, meaning they were down a lot more than sales were down. The incremental restructuring in the fourth quarter, the way you're handling the inventory, you know it does seem likely at least you're doing the right thing so to speak for maybe a slower ‘20.

Can you help us a bit with the inventory, how you view it in your channel? You know obviously your own inventory as I just said sort of did a pretty good job sequentially year-over-year. Can you help us with the channel inventory color?

Scott Santi

Well, I think from the standpoint of channel inventory and we talked about this before, but we are – given the performance embedded in, let’s call it the operational X, you know elements of 80-20, you know we are you know for 90% plus of what we sell. You give us an order today, we ship it tomorrow.

So from the standpoint of channel inventory, I think that's an advantage and from the standpoint of our channel partners in terms of minimizing their need to carry a lot of inventory, so you know I think it’s one of the reasons why we tend to have these external market inflection one way or the other show up in our business quicker than maybe some others where there's more backlog involved.

I think that's a real advantage, but you know I don't think we're going to talk about destocking or any of that stuff, because I don't really think it's an issue from our standpoint given the relatively low level of them toward that are – I mean there are some out there certainly, but it's not a material element given the way we’re able to service our channel partners.

David Raso

So that's interesting. You're saying the improvement in the inventory management, 2Q to 3Q that we normally say again year-over-year, that was just normal course a business. You would say that was not any proactive…

A - Scott Santi

Right. That – we’re not getting into a lot of detail. That’s just – there's a self-correcting element to demand found where you know all that stuff is. We’ve talked about this before and we’ll show it to you in Fort Worth a little bit when we visit there, but essentially we are producing today what our customers bought yesterday. So there's no forward forecasting in our raw material replenishment. It's all basically replenishment from vendors, so it’s essentially self-correcting to the demand environment, which is the reflection and what showed up or what you are looking at.

David Raso

Right. Well, lastly – thank you. The portfolio management, that half of the asset sales are still hope to be done by the end of this year. Can you just give us an update on – you know we're only few months away. Is it a matter of the right partners, is it you know still discussing the price? Just to make sure we're comfortable and we still see some of those asset sales done by the end of this year. Thank you.

Scott Santi

Yeah, it's a little bit of all of the above. I mean I think these processes are all in various stages. In terms of negotiations and you know I think we've talked about our goal is to get half of these transactions completed this year and all of them completed by the end of next year.

I'll say in terms of overall financial impact, you know there may be some one-time gains on sale that I'm sure you know we're going to call those out and you can adjust our EPS numbers based on that. I think fundamentally from a financial standpoint as we look forward, this is to 2020, the EBITDA that we are divesting here, that will essentially be offset by lower share account. So from an EPS standpoint there really is no significant impact on the company.

And then structurally when all of these are completed by 2020, which is certainly our goal, you know structurally there's an element here of addition by subtraction as we've talked about. That's the 50 basis points of improvement in the organic growth rate and 100 basis points of improvement in our underlying operating margins.

David Raso

Right, thank you.

Scott Santi

Sure.

Operator

Your next question comes from Joseph Ritchie from Goldman Sachs. Your line is open.

Joseph Ritchie

Thanks, and good morning, everyone.

Scott Santi

Good morning.

Joseph Ritchie

So maybe asking David's question a little bit differently, I know you don't want to give an explicit guide for 4Q, but if we think about the full year guidance of 24% at the operating margin level, it implies that 4Q is going to be down year-over-year, you know call it roughly 50 to 60 basis points, and I'm trying to understand the moving pieces. So I recognize restructuring has now been increased to the fourth quarter, but there is also a $0.05 benefit from what I remember coming through in 4Q as well. And so maybe you can just kind of help me with the moving pieces year-over-year.

A - Michael Larsen

Yeah, I mean Joe. I'm not sure I can add much more to what I said previously. I mean we've given you the elements here, you're right. I mean higher restructuring we talked about, you know there's an assumption of lower volume, which includes and you know we talked about extensively the GM impact. And then certainly we expect to see you know enterprise initiatives continue to contribute at a high level and price cost trends are positive. So I think those are kind of the pieces here.

Again, you know like I said, this is a – things are in the round here. We're talking about decimal points of differences and you know I wouldn't get too caught up in kind of the Q4 versus full year margin number. I think for the full year, in a pretty challenging year you know margins are essentially flat.

If you take out the restructuring, margins are improving year-over-year which is the Q3. 40 basis points a margin improvement, detrimental margins of 15% and so I think the company is performing at a pretty high level just given the environment that we're in, so…

Scott Santi

And I'll just extent that. I know we should – in any way interpreting this is the same. We are not fully on track to take in our margins to where we think we can on a long term basis by 2023, right.

Joseph Ritchie

Okay, and maybe I'm going to follow-on that question and Scott, as you kind of think about the moving pieces, I know you're going to give explicit guidance at the Analyst Day in March. But as you kind of think about the moving pieces, you know obviously commodities have become a little bit more of a tailwind for a lot of industrial companies, your price costs only turned positive, which is great. But there's also been additional investment spending that has been a bit more of a drag on the overall margin in recent years and so maybe you can provide a little bit more of a bridge for next year and how we should be thinking about the different moving pieces as you guys see it.

A - Scott Santi

Well, I don't know that I can give you a lever. In terms of specifics we're going to give you our guidance. As Michael said in January, we haven't even completed the planning process yet. We do that typically in November, so all I can tell you from the standpoint of moving pieces is for sure we have a backlog of enterprise initiative projects. We expect continued margin improvement structurally from those next year.

I can't exactly dimension it for you yet, because we haven't gone through the planning process, but I would say it would be you know my – sitting here today that would be – it would be in line with what we did this year, which is a full point or so give or take.

You know and the other big question for next year is going to be where does the volume go in terms of the macro. This is a company that's really well set up. In terms of leverage if we can get some volume growth going from the standpoint of end markets, but if we see further deceleration in 2020, then we'll, you know we'll react to it. I think we'll operate well either way and then these divestitures will as Michael said, add a full point of margin performance as we work through those and complete those by the end of next year.

So I think from the standpoint of the overall margin profile of the company and you know the clarity of our path to where we said we were going to get 2023, I don't see anything that's also becoming an obstacle to that for sure.

Joseph Ritchie

Okay, thanks for your time.

Operator

Your next question comes from Stephen Volkmann from Jefferies. Your line is open.

Stephen Volkmann

Hi, good morning. Thanks for taking my question. Just a couple of quick follow-ups. Michael, I think you sort of talked about this already, but you're not looking at any meaningful changes in things like PLS, enterprise initiatives, price cost, etcetera for the fourth quarter, that's not part of the equation here? Hello?

Operator

We are experiencing technical difficulties. Please stay on the line.

And you're now reconnected.

Stephen Volkmann

Hi guys, can you hear me?

Karen Fletcher

Yes, sorry we lost the connection in our room, so you'll have to start from the beginning. Sorry about that.

Stephen Volkmann

Okay, good. I don't think it was my fault, I didn't touch anything.

A - Scott Santi

I think Joe didn’t like the last question. [Cross Talk]

Stephen Volkmann

Yeah sorry, this is Steve with Jeffrey. So I just had a couple of quick follow-ups and the first one Michael, I think you kind of touched on this stuff, but I just wanted to make sure you weren’t forecasting any meaningful changes in the cadence of things like PLS, enterprise initiatives, price cost in the fourth quarter to kind of explain a little bit of that shift.

Michael Larsen

Yeah, that's correct, yeah we're not – that’s not what we're talking about.

Stephen Volkmann

Okay, great. And then this is maybe a slightly annoying question, but assuming you get 50% of your divestitures done by the end of this year, does that mean that 50% or 50 basis points of even improvement sort of flows into 2020 or are you potentially kind of working on the bigger return projects first and it might be a little higher or perhaps lower even, I don't know.

A - Michael Larsen

Yeah, I mean directionally, I'd say about half of the impact. If everything – theoretically if everything gets done by year-end 2019, so like let’s say everything – half of the projects that we're working on, they all get done by year-end, you will see approximately half of the benefit that I mentioned earlier in 2020, and then when everything is complete as they were targeting by the end of 2020, so 2021 will be the first year where you would see a full 50 basis points of organic growth and 100 basis points of structural margin improvement, so hopefully that’s clear.

Stephen Volkmann

Yeah, very clear. Thank you so much, I'll pass it on.

Michael Larsen

And then any EPS impact will be – you know the goal is to completely offset that so we shouldn't see anything from any EPS standpoint.

Stephen Volkmann

Got it, thank you.

A - Scott Santi

Yeah, some one-time gains that would flow through, yes.

Operator

Your next question comes from Vlad Bystricky from Citi. Your line is open.

Vlad Bystricky

Good morning, everyone.

A - Scott Santi

Good morning.

Vlad Bystricky

So just going back to the segments here for a minute, you gave obviously some good color around the GM issues in North America. But if I look at auto OEM, you actually had pretty nice rebound in organic there internationally. So can you give us more color on what's really going on in Europe and especially in China where the out performance versus builds you know really widened this quarter?

A - Scott Santi

Yes, so I think in Europe we talked about I think in the last call, things appearing to begin to stabilize in Europe and so we've gone from being down kind of mid to high single digits to you know now flat as builds have recovered as well in Europe, so.

And then China was really the big outperformance there as really as a result of continued penetration gains, primarily with local Chinese OEM's. So even in a market where builds are down kind of in the mid-single digits here in Q3, we're able to outperform and grow our business you know 7%. So it's nothing new. It's really a continuation of the strategy that we've been pursuing there for many years, so.

Vlad Bystricky

Okay, that's helpful. And then maybe just stepping back bigger picture, at the last analyst day you categorized the divisions into three groups that you've talked about a bit; ready to grow and growing versus ready to grow and not yet growing versus long term challenge. Now that we've had a bit of a hick-up in the macro, can you give us some more color on how each of those three groups of businesses have been performing through the current slowdown and whether you're seeing anything that changes how you may be thinking about the longer term outlook for any of the particular businesses.

Scott Santi

We haven't seen anything that changes our view of both the potential from the standpoint of growth in any of those businesses and also in terms of the agenda and the things we need to do to get them to deliver growth to that full potential. We'll give you guys a really good update, I promise, when we meet in March, in terms of exactly how those different types of businesses performed, even through this period where there's some macro pressure.

Vlad Bystricky

Okay, that's helpful thanks. I'll get back in queue.

Scott Santi

Alright, thanks.

Operator

Your next question comes from Nigel Coe from Wolfe Research. Your line is open.

Nigel Coe

Thanks guys. Good morning.

Scott Santi

Good morning.

Nigel Coe

I apologize. I'm going to go back to well-trodden ground here. There's a lot of confusion about your – what the message is on Q4 margin, and if we take what you said, which is point us towards the lower end of the range, for obviously, one understands the reasons, it does point to a so 24% margin for 4Q.

So we've got a higher structure, it's about 30 basis points based on the $0.03 impact. Is it just simply lower volume? I'm asking this in a sort of track to clear out some confusion out there. This could be lower volume in Q4 of the business Q3 with some GM impacts in some of that. But just – if you just could clarify that point that would be very helpful.

Scott Santi

Yes, so two things Nigel. So let me recap what I said earlier, maybe say it a little more clearly. So one is typical seasonality if you go back and look, our orders, our margin rates go down from Q3 to Q4 because of the volume goes down, so that's one piece here.

The second piece is higher restructuring on a year-over-year basis, and then the third piece is lower volume, and so including the potential GM impact that we quantified earlier.

So it's really those three elements that are you know factored into the overall equation and our overall guidance, and even with those elements, you know within EPS, within organic growth guidance and that we treat the margins for the full year really to reflect everything I just talked about. And again, we're talking about decimal points on rounding's here.

Nigel Coe

That's great, that's very helpful and then of course another fact would be that you typically managed down inventory from Q3 to Q4, so that's where you got some production currency there as well and you know to shut down especially in Europe. So I'm just curious, you did a great job of managing inventory, you know David Raso that you know earlier in the call. Are you planning to take another say $50 million to $100 million inventory out in Q4, just typically what you do?

Scott Santi

It would – we don't have any forward plan to do that. As I said earlier, you know the system for us is essentially self-correcting to the level of demand that our businesses are experiencing week to week and so in a way I would say yes, because normally fourth quarter volumes dip from Q3 and therefore inventory and actually it follows that path. But it's more of a, just a way the 80-20 operating system operates. It's not a you know what, not to tell people to do it.

Nigel Coe

Yep, okay, well thanks. Hopefully that's the last Q4 margin question. Thanks a lot.

Scott Santi

Alright, thanks.

Operator

Your next question comes from Mig Dobre from Baird. Your line is open.

Mig Dobre

Hi, good morning. I will not ask about the margin in the fourth quarter, but I will ask about your revenue guidance. Not sure if I missed this, but you reduced revenue by $300 million versus the prior guidance, call it a little over 2%. What were the moving pieces here in terms of FX, organic hit from GM macro?

Scott Santi

Yeah, I mean the big difference is really you know the currency piece. So we have you know a more headway on the top line and on EPS relative to when we gave guidance in Q2, really as a result of foreign exchange rates moving against us here since July when we were on the last earnings call.

Mig Dobre

Okay, so that’s, it’s all FX.

Scott Santi

Yes.

Mig Dobre

I see. And then my follow-up going into segments again, I'm looking at the welding business and to me it's pretty remarkable that your volumes have grown in North America in the quarter. Certainly that's not what I'm hearing when I'm talking to people in the industry and we all sort of see that some big customers, especially on the heavy equipment side are cutting production.

So I'm kind of wondering why that's happening and what your hearing from your business operators there. Are you taking share, are there some other dynamics or is it simply that the environment is not as dire as we're all thinking and that may be the flipside applies to Food Equipment, which has slowed and I would think that that market is not as macro sensitive, maybe as welding as for instance.

Scott Santi

Yes, so let me start with the welding. I mean in think we characterized it as a pretty stable and just to be clear, our organic growth rates, we don't break out volume versus price, right, so that may be part of – and I don't know what everybody else is saying at this point, but that may be part of the difference here on the welding side.

You know Food Equipment, you know we did continue to see solid growth on the institutional side as we talked about restaurants flattish and then really the softness if you want in food was on the retail side and we can point to some specific orders that were pushed out to Q4 and so the underlying order rates on the food equipment side are pretty good. So that's how we tried to characterize it earlier.

Mig Dobre

Alright, thank you.

Scott Santi

Thank you.

Operator

Your next question comes from Walter Liptak from Seaport Global. Your line is open.

Walter Liptak

Hi, thanks. Good morning guys.

Scott Santi

Good morning.

Walter Liptak

Just a follow-on with the food equipment segment. The restaurants being flat, you know I think that was growing pretty rapidly for you guys in prior quarters and you called out some CapEx things as slowing. I wonder if you can just provide some more color about what you're seeing in that restaurant segment?

Michael Larsen

Yeah, I mean I – all right, so we'll give you a little more detail here. In terms of the QSR side, fast casual actually showing continued to show really strong growth on a year-over-year basis and it's really more of kind of the full service, think like fine dining type that was a little bit slower here in the quarter. So net-net we ended up at about flat on the restaurant side.

Walter Liptak

Okay, but what – but that flat I think was down from prior quarters. I think you guys were up high single digits in the first half. Was there something that slowed?

Michael Larsen

I have to go back and look, I mean – and how comps played into that. I mean I think the best I can tell you is the description I just gave you. I think comps probably if you factor that in are the main driver, but we can follow up on that.

Walter Liptak

Okay. All right, thank you guys.

Scott Santi

Sure.

Operator

Your next question comes from Josh Pokrzywinski from Morgan Stanley. Your line is open.

Josh Pokrzywinski

Hi, good morning guys.

Scott Santi

Good morning.

Josh Pokrzywinski

Just a first question maybe to help level set on some of this price cost. Michael, I think if I look back historically, we're kind of in the zip code of where you know price cost is normally I guess kind of topped out in deflationary environments, kind of in this 20 maybe 30 basis point range. Is there something that kind of governs that system based on the mix of business from going higher or should we think about you know something in the zip code as kind of being historically more of high end than something that can go higher.

Michael Larsen

No, I mean I think historically what we've – our goal has always been to just offset any material cost inflation with price, and you know that's what we've done so far this year. If you're asking whether things are going to accelerate from here in terms of the 20 basis points of price cost, I wouldn't make that assumption if that's your question.

Josh Pokrzywinski

Got it, that's helpful. And then just a follow up, you know thinking about the auto side, but maybe more in Europe where we have some changes coming down the road on emissions and maybe some of the OEMs get a little pinched on mix next year. Have there been any discussions about any kind of mix changes or you know folks getting more, I guess you know kind of aggressive on pushing back on prices than usual just as a function of some of the margin challenges the OEMs will be going through next year. Thanks.

Michael Larsen

So we haven't through any of the plans yet, but I would be very surprised if we heard somebody describe the environment the way you just did, so I think we…

Scott Santi

I don't know how you can push back more.

Michael Larsen

It's a tough industry and in automotive you know our positioning has a very niche, value added solutions provider. You know it's fueled by innovation and thousands of patents, that's how we generate price in automotive, but the cost pressures will always remain and that hasn't changed and I'd be surprised if that would change on a go forward basis, so…

Josh Pokrzywinski

Got it. Thanks, I'll leave it there.

Scott Santi

Sure.

Operator

Your next question comes from Steven Fisher from UBS. Your line is open.

Steven Fisher

Thanks, good morning. I just wanted to clarify the non-residential construction versus the resi comments you made there, where you said resi was up and non-resi down. Can you just clarify was that specifically North America or more broadly, and then can you just give a little more color on what parts of the non-res market are driving that lower.

Michael Larsen

So, like I said, this was a North American comment and the residential remodel side continues to be really solid and so that's where we experience 4% growth here in the quarter and that's really the – what we call the age of the business; that's the bulk of the business in North America.

You know the commercial side can be a little lumpier. There's a project business in there. One of the products that we provided is we pour concrete floors for warehouses and data centers and some of those projects can move in and out of the quarter, and you know this quarter that business was down in the low to mid-teens and kind of offset into North American and ended up basically flat.

Scott Santi

Let me just clarify, we make products that people use and they pour on those floors, we don't do that.

Michael Larsen

We don't pour it, we make the…

Steven Fisher

Sure, understood. And then just related to the auto side of the business, how does your content per vehicle for 2020 look relative to 2019. I imagine at this point you have some view of that. Just kind of curious, what kind of growth you have in the bag already from a content perspective.

Michael Larsen

Yeah, I mean the content as we talked about before is locked in for the next two to three years, so that's content growth. Obviously we don't know what the auto builds are going to be, but in terms of new product launches and content of new vehicles, the whole business is geared around you know 200 to 400 basis points of above market growth as a result of continued penetration gains. Obviously that number is higher in China as you saw this quarter again, and have seen for many years, but on average it's in that 200 basis to 400 basis range and that hasn't changed.

Steven Fisher

Okay, thank you very much.

A - Scott Santi

Sure.

Operator

Your last question comes from Nathan Jones from Stifel. Your line is open.

Nathan Jones

Good morning, everyone. Thanks for fitting me in.

Michael Larsen

Good morning. Sure.

Nathan Jones

Michael, you made a comment that I don't think anybody's asked you about, that the test and measurement in electronics orders were actually pretty good. I think that's probably a bit surprising given the soft CapEx environment. Can you maybe talk a little bit more about what was driving that, whether you know there is just some timing impact there or it's more of a you know an improving trend you're seeing.

Michael Larsen

Yeah, I mean I think as you look at the test and measurement business, so down 4% but up 1% excluding the semi-business. We've seen actually some – a couple of months here on the semi side from an order standpoint and then the electronics business is down really primarily driven by electronic assembly. And here similar to what we talked about early, we had some orders that we're differed from Q3 into Q4, and so…

But the MRO side inside of electronics and more I think like clean room technology is pretty stable. But again, it's really more – so that the pressure is really more of the on the equipment side. But again order rates are somewhat encouraging as we head into Q4. If you look at historical, Q4 is always the biggest quarter for the test and measurement business. So that's probably as much color as I can give you.

Nathan Jones

Okay, and I guess my follow-up question on enterprise initiatives, you guys are looking for a four point this year and four point next year. If I think back a couple years to your Analyst Day in 2017, I think you said 2018 would be a 100 basis points, 2019 will be like half that and then you thought the margin tailwind from enterprise initiatives would be over. Clearly you're out performing that, so maybe you just talk a little bit about, you know the kind of things you have found at a time to continue to drive that, and whether there's an expectation that you can continue to drive margin improvement out of EI past 2020.

Michael Larsen

Well, I think that's a great question, and I think we'll be spending quite a bit of time on that at Investor Day. I mean I think part of what's going on here is 80-20 is – the core element here is that of continuous improvement and you know I think the more work we do in this area, the better we get at 80/20, the better the raw material in terms of the underlying businesses, you know the more opportunity we find.

And so if you recall all the way back to when we launched the enterprise strategy, the goal was to get to 20% EBIT margins. Today we are sitting in the mid-20s with a clear path to 28% in the not too distant future, and it's not that we knew all along, that's what we were going to end up with. It's really that we keep getting better and better at 80-20, and 80-20 today as our operating system is more powerful than it's ever been in his to the company and it continues to evolve. So you know I can't give you specifics in terms of basis points for next year yet, but we expect to continue to make progress consistent with what we've done over the last six years and I'll just want one more data point.

If you look at, this is not one or two segments driving this. This is really broad based. I think we said between 80 and 190 basis points across the segments and so that gives me and should give you some confidence for sure that there's a lot more opportunity to come here from the margins standpoint, so…

Nathan Jones

Very helpful. Thanks very much.

Scott Santi

Okay, great. Thank you.

Operator

We have no further questions. I'll turn the call back over to Karen Fletcher for closing remarks.

Karen Fletcher

Okay, thanks Julianne. Thanks for joining us on the call this morning and feel free to reach out to me if you have any further questions. Thank you.

Operator

This concludes today's conference call. You may now disconnect.