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Avery Dennison Corporation (AVY) CEO Mitch Butier on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-23-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $1.66 beats by $0.05 | Revenue of $1.76B (0.10% Y/Y) beats by $11.16M

Earning Call Audio

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Avery Dennison Corporation (NYSE:AVY) Q3 2019 Earnings Conference Call October 23, 2019 1:00 PM ET

Company Participants

Cindy Guenther - VP, IR and Finance

Mitch Butier - Chairman, President and CEO

Greg Lovins - SVP and CFO

Conference Call Participants

Ghansham Panjabi - Robert W. Baird & Co.

Adam Josephson - KeyBanc Capital Markets

George Staphos - Bank of America Merrill Lynch

Jeff Zekauskas - JP Morgan Securities Incorporated

Joshua Spector - UBS Securities LLC

John McNulty - BMO

Anthony Pettinari - Citigroup Global Markets, Inc.

Rosemarie Morbelli - Gabelli & Company Incorporated

Paretosh Misra - Berenberg Capital

Chris Kapsch - Loop Capital

Operator

Ladies and gentlemen, thank you for standing by. Welcome to Avery Dennison's Earnings Conference Call for the Third Quarter ended September 28, 2019.

During the presentation, all participants will be in a listen-only mode. Afterwards, we will conduct a question-and-answer session. [Operator Instructions] This call is being recorded and will be available for replay from 12:00 pm Pacific Time today through midnight Pacific Time October 26th. To access the replay, please dial 800-633-8284 or 1402-977-9140 for international callers. The conference ID number is 21896770.

I'd now like to turn the call over to Cindy Guenther, Avery Dennison's Vice President of Investor Relations and Finance. Please go ahead, ma'am.

Cindy Guenther

Thank you, Ash. Today, we'll discuss our preliminary unaudited third quarter results. Please note that, throughout today's discussion, we'll be making references to non-GAAP financial measures. The non-GAAP measures that we use are defined, qualified and reconciled with GAAP on pages A-4 to A-8 attached to the financial statements accompanying today's earnings release and the appendix of our supplemental presentation materials.

We remind you that, we'll make certain predictive statements that reflect our current views and estimates about our future performance and financial results. These forward-looking statements are made subject to the safe harbor statement included in today's earnings release. On the call today are Mitch Butier, Chairman, President and Chief Executive Officer; and Greg Lovins, Senior Vice President and Chief Financial Officer.

I'll now turn the call over to Mitch.

Mitch Butier

Thanks, Cindy, and good day, everyone. We delivered solid profit growth in the third quarter despite softer-than-usual market demand with EPS once again up double-digits over prior year on a constant currency basis. Our focus in this slower growth environment has been to protect, even expand our margins in the base business, while driving faster than average growth in high-value categories like RFID. We're executing well on both fronts.

We appear to have recaptured most of the share we've recently lost in LGM. Our intelligent labels platform continues to drive over 20% growth from RFID enabled solutions and IHM's commercial execution continues to improve. At the same time, a relentless focus on productivity was again a key driver of margin expansion for the Company this quarter. In sum, we are making good progress against our key strategic priorities and are on track to deliver our long-term financial targets.

Label and Graphic Materials posted strong profitability on roughly a point of organic growth for the quarter driven primarily by volume. High value categories again grew faster than the base. As I mentioned, though all the market data isn't in yet for the third quarter, we have good reasons to believe that by the end of the quarter, we had recaptured the bulk of the share we ceded at the tail end of the inflationary cycle. In terms of global market trends, it appears that the soft market conditions that we saw in the first half of the year largely continued into the third quarter with a modest improvement in Europe offset by a moderation of demand in South Asia.

Retail Branding and Information Solutions delivered solid organic growth, driven by ongoing strengthened RFID and external embellishments, which more than offset declines in the base apparel business. As we mentioned in July, we thought trade-related uncertainty impacting orders in the second quarter. This is uncertainty was reinforced when additional tariffs were announced in August.

Now, while trade related issues are causing near-term uncertainty, we are well positioned in the base business given our global footprint and differentiated product and service capabilities. As for RFID, the growth trajectory continues to be resilient, with continued strength and apparel and even faster growth from other promising verticals, though obviously off of a small base.

Our total pipeline with customer engagements continues to expand, up more than 40% from just the beginning of this year, driven primarily by categories outside of apparel. As the leader in ultra high frequency RFID, we are positioned extremely well to capture these opportunities with industry leading innovation and manufacturing capabilities and the best most experienced team in the space.

We continue to increase our level of investment in business development and other resources to drive this growth. As we build out our intelligent labels platform to enable a future where every item can have a digital twin and digital life. In Industrial and Healthcare Materials sales growth was relatively strong on an organic basis, due in part to lapping the slowdown in China's automotive market last year.

That said, given the high proportion of this segment portfolio that is focused on industrial and markets, I'm pleased with the solid top-line performance the team delivers. And importantly, we made excellent progress in the quarter towards achieving our operating margin target for the business.

Ensure another solid quarter overall in the midst of a challenging environment. Our strategies to deliver outsized growth in high value categories are working. And our relentless focus on productivity continues to enable us to increase our pace of investment in these categories, increase our competitiveness overall and grow profitably in our base businesses, while importantly, continuing to protect and expand operating margin.

Well, we lowered the hind end of our near-term outlook for top-line growth due to recent market trends and currency shifts caused us to reduce the high end of our EPS guidance for the year. We are confident in our ability to achieve our long-term objectives, including GDP plus growth and top cortile returns. We will continue to seek opportunities to leverage our positions of the strength commercially, operationally and financially and as you've heard me say before, be prepared to lean forward even as others may pull back.

Now turn the call over to Greg.

Greg Lovins

Thanks and hello, everybody. As Mitch said, we delivered another solid quarter with adjusted earnings per share of $1.66, up 14% despite the currency headwind. We grew sales by 2.1% on an organic basis, and currency translations reduced reported sales growth by two points in the quarter, and our adjusted operating margin increased by a full point to 11.7%.

We realized $18 million of restructuring savings net of transition costs in the quarter due in part to LGM's restructuring in Europe that was largely completed as of the end of Q2 and our cash generation has been strong. We've delivered $327 million of free cash flow year-to-date up $67 million compared to the same period last year.

As we've discussed, we've increased our pace of fix capital in IT-related spending for a few years to support our long-term organic growth and margin expansion plans. With capital spending expected to be up by about $20 million this year and we continue to return cash to shareholders.

In the first three quarters of the year, we repurchase roughly 2 million shares at an aggregate cost of $204 million and paid $141 million in dividends, for a total of $346 million in cash return to shareholders.

Importantly, our balance sheet remains strong, with net debt to adjust EBITDA kicking down slightly in the quarter. Our current leverage position gives us ample capacity to continue executing our disciplined capital allocation strategy, including investing in organic growth and acquisitions, while continuing to return to shareholders. We are well positioned to take advantage of any dislocations in the market should they occur over the next few years.

Turning to the segment results for the quarter. Label and Graphic Materials sales increased by 1.2% on an organic basis, driven primarily by higher volume, as we've now left, the bulk of last year's price increases. Growth in LGM's high value categories led by specialty labels, continue to outpace the growth of the based business.

And breaking down LGM's organic growth in the quarter by region, North America was roughly flat, while Western Europe was up low single-digits. Emerging markets also grew at a low single-digit rate with China up low single-digits in South Asia up mid single-digits.

Adjusted operating margin for the segment was strong at 13.5%, up 120 basis points compared to the prior year, reflecting the benefit of productivity initiatives, including restructuring and material reengineering, partially offset by higher employee related costs. The net effect of changes in price and raw materials and freight input costs was neutral for the quarter.

Shifting now to Retail Branding and Information Solutions, RBIS delivered solid top line growth of 4.1% on an organic basis, driven by faster growth and high value categories, with RFID's sales up roughly 28% and external embellishments growing even faster.

Our based business adjusted for the migration of products to higher value RFID solutions was down low single-digits. Adjusted operating margin for the segment increased 10 basis points to 11.5%. As productivity gains were largely offset by long-term growth related investments primarily related to RFID.

Turning to the Industrial and Healthcare Materials segment. Sales are up 3.7% on an organic basis, reflecting both volume growth and higher prices. Sales for industrial categories were up low to mid single digits, driven by solid growth in auto related categories. And healthcare categories grew even faster, up high single digits with medical up in the high teens.

We made excellent progress on the margin front in IHM. Adjusted operating margin increased by 180 basis points to 11%. As a benefit from higher volume and productivity more than offset higher employee related costs. The normal seasonality does call for sequential easing in margin for the fourth quarter, I am confident we will exceed the 10% we targeted for IHM for the full year.

Focusing now on our outlook for 2019. We've lowered the high end of our guidance range for adjusted earnings per share, reflecting incremental currency translation headwinds, largely offset by stronger operational results in a modestly lower tax rate compared to our previous expectations. We have reduced our outlook for full year organic sales growth to a range of 2.0% to 2.3%, which implies 2% to 3% growth for the fourth quarter.

As you know in our short cycle businesses, visibility to demand is very limited and we've seen increased variability in order patterns from month-to-month. So, the lower end of our organic growth outlook assumes a continuation of the 2% we've seen year-to-date including the first few weeks of October. On the high-end reflects the fact that comparison to do easier for us over the balance of the quarter.

We've outlined some of the other key contributing factor to our guidance on Slide 9 of over supplemental presentation materials. In particular and just focusing on the material changes from our assumptions in July, at recent exchange rates, currency translation represents a roughly 3.5% headwind to reported sales growth for the year with a pretax operating income hit of $37 million, an incremental $9 million headwind relative to the 28 million we were anticipating in July.

Partially offsetting this, we now estimate the incremental pretax savings from restructuring, net of transaction costs will contribute approximately $50 million. As the teams have been executing very well against our plans, we look to deliver at the high-end of our previous expectations. We realized about $35 million of these savings in the first three quarters of the year. And a tax rate should come in slightly lower than our previous outlook, which I assumed 25% at the midpoint of our guidance range.

In summary, we delivered another solid quarter in a more challenging environment and we remain on track to deliver on our long-term objectives to achieve GDP plus growth in top quartile return on capital, which together drive sustained growth EVA.

And now we will open up the call for your questions.

Question-and-Answer Session

Operator

Thank you. [Operator instructions] Our first question comes from the line of Ghansham Panjabi with Robert W. Baird & Co. Your line is now open.

Ghansham Panjabi

I guess first off on LGM. Maybe you can just give us a little bit more color, Mitch, how volume kind of played out through the course of the quarter? Which regions did you capture share within from a geographic standpoint? What's your sense from customers as it relates to the outlook for 4Q and 2020? Are they kind of managing inventory very tightly? More optimism, less optimism, how would you sort of characterize that dynamic?

Mitch Butier

So, a lot in there, Ghansham. So, specifically with the quarter, basically if you look within July growth started out relatively soft, soften further in August and then came back in September. We're now seeing a bit of moderation as Greg talked about early October again. So, a little bit more of the choppiness that we talk through.

In North America, so just from a market perspective, in the markets, we're seeing pretty consistent low single-digit growth between last year and this year. Our growth, of course, was lower than that in the first half of the year because of the share losses, which we since believe we are on the solid path to recapturing. And, in Europe, we saw low to mid single-digit growth last year as you know, in the first-half, really no growth pretty flat environment and we're announcing a little bit of a pickup low single-digit growth in Q3, mostly in Southern Europe are not in North or Central Europe overall.

And then in China, we saw low mid-digit last year growth and we saw frightened first-half of this year and started to see some positive growth here in Q3, mid single digits, and South Asia as we called out that's where we saw a shift and its really beyond. So India continue to have strong growth high single-digits and specifically, Malaysia and Thailand where we're seeing some softness which we attribute broadly to softer market conditions and the link between China and U.S. trade matters.

So as far as sentiment of the customer, basically the sentiment reflect those market trends overall. So generally, the customer sentiment we've had at Labelexpo recently, it was well attended by customers particularly from Europe, once in Southern Europe and Eastern Europe, sound a little bit more confident about near-term outlook than the ones from

Northern and Central Europe specifically. Overall, a lot of excitement though about the innovations, and a lot of interest coming from customers of what we can bring to the table to help to together grow the market.

Ghansham Panjabi

Okay. And then just my second question, sticking with LGM, looks like prices starting to kind of flatten out year-over-year. That's been pretty consistent with what you said last quarter as well, but just kind of looking at the next few quarters. How would you have us modeled price mix? Do you expect a negative sign in front of that? Or do you think that, that will be essentially flat just it was in 3Q? Thanks so much.

Greg Lovins

This is Greg. So overall, we have seen pretty neutral net price inflation here in the third quarter versus prior year and also relatively neutral sequentially. So, we have seen a little bit of sequential deflation, largely coming from some easing and paper here in the third quarter. At the same time, we have got some pockets of price down as we have seen some sequential deflation over the last couple quarters. But overall, we're looking at kind of price inflation relatively neutral year-over-year in Q3 as well sequentially a little more sequential modest deflation we think in Q4, but not a material impact overall.

Operator

Our next question comes from the line of Adam Josephson with KeyBanc Capital Markets. Your line is open. Please go ahead.

Adam Josephson

Mitch or Greg, just one question on Greg's comments toward the end of the prepared remarks, you talked about seeing increasing their variability in order patterns from month to month. Just hoping it could clarify what you tribute that to. And then you talked about on the first couple weeks in October being upload to similar to what you had in 3Q. But I think for the quarter, you're thinking anywhere from two to three, I guess because the comps get easier as the quarter goes on. So I'm just hoping I understand those two issues a bit better.

Mitch Butier

Yes, it's quite simply Adam. The volatility we called it out a little bit more for us to choppiness in demand last quarter. We're continuing to see what do we attributed to it's basically just some of the uncertainty that's going on in the environment. If you look at political uncertainty around Brexit impacting Europe, if you look at what's going on in Hong Kong, and then the trade matters tariffs on again, off again, on again.

So those are what we attribute in general the more lumpiness or not uncommon and LGM in particular, to have a few weeks of just goes above normal or below normal. But we're just been seeing it more consistent into a somewhat larger degree. And we're talking about still within a relatively tight band. It's not dramatic swings, but we are seeing more choppiness than we've traditionally seen in the LGM, as well as in RBIS. As far as the other part of your question about the, I think Greg explained Q4.

Greg Lovins

So Adam, this is Greg. In Q4 of last year, our strongest volume market was in October and then volume softened quite a bit November and December. So we do a little bit easier comps in the back part of this quarter. Whereas we started Q3 or started Q4, a little bit the lower end of our range for the quarter.

Adam Josephson

Just one on the raw material, I think Ghansham asked about raw materials or price cost specifically said it was flat and you expect similar trends thereafter. Can you talk about what exactly you saw with your paper costs and your chemical costs in 3Q obviously, there's been quite a bit of global paper market weakness and we're just trying to get a sense of precisely how much your paper costs fell either sequentially or year-over-year and what you're saying in terms of paper prices going down?

Greg Lovins

Yes. So, I guess, as we move through this year in the first half of the year, we've seen some benefits in chemicals as we're moving across the quarters. And then paper started to be a benefit for us in Q4 -- sorry in Q3. Overall though, still I think, kind of low-single-digit type of deflation sequentially, very low and total with a little bit heavier and paper. So still not a huge impact, but low-single-digit deflation as we came into Q3 from largely from paper.

Operator

Our next question comes from the line of George Staphos with Bank of America Merrill Lynch. Your line is open. Please go ahead.

George Staphos

My two questions to start around margin. One question specifically within RBIS and then kind of a broader question on that in terms of cost saves. With RBIS, the incremental margin was quite a bit lower than what we've seen in prior quarters, it's not totally surprising, given the cadence of restructuring and every quarter can be phenomenal. And you also called out the spending on growth with an RBIS. Would it be possible to give a bit more color in terms of what some of those incremental costs might have been in the third quarter or any other sources of deceleration in incremental margin within RBIS to the extent that you can comment?

Greg Lovins

George, this is Greg. So, just as you said, the variable flow through we got from the top-line growth was largely in line with what we would have expected from that. The same time is, as you mentioned, as Mitch mentioned earlier, we have been continuing to invest particularly in RFID, and we had investments in the quarter of a few million dollars versus where we were a year ago. So that offsetting some of that variable flow through. Otherwise, generally in line with what we would have expected at that level.

Mitch Butier

Okay, George. And I think, just overall, just the margins you see for all of our business and in particular, RBIS, the expansions we've been able to achieve are I think even more impressive when you consider how much we've invested, particularly in Intelligent Labels over the past couple of years. So, between last year and this year, we will have added more than $20 million of organic OpEx to this business, really in the business development areas and so forth that we've talked through. And this just reinforces our strategies trying to invest more to accelerate growth in high value categories, and the relentless focus on productivity to both fund those investments as well as expand margins.

George Staphos

Mitch, the $20 million was over what period did you say, the last few years, was there a specific increment there?

Mitch Butier

‘18 to ‘19.

George Staphos

And then, my second question, when we consider the restructuring, I think, you said you had $35 million of savings year-to-date. If I heard that incorrectly, if you can put in the correct number for us. And $50 million is the goal. What -- for this year, what's next? Obviously, Avery always focuses relentlessly, maybe to use your term, on productivity, some of it is driven by the growth initiatives that in turn drive the ability to then restructure once you get the top line growth. Sometimes, it's driven by the investments that you make. Obviously, you've had a new coder come up. What kind of pace on productivity should we expect over the next couple of years within your segments? Would we see a bit more perhaps in one segment versus another? Thanks.

Mitch Butier

So, George, I'm not going to get into specifics of that. Just overall, I think, you've captured it. This is a key strategy of ours; it’s one of the key four strategic pillars, the relentless focus on productivity. And we see restructuring as one of a number of levers to pull. Our constant focus on material reengineering, lean sigma are key tenants of our strategy, and restructuring, we think of is innovation of our fixed cost structure. So, we will communicate that as we normally do with annual guidance on what we expect for the given year, and as we do these programs and so forth. So that's -- we’re not going to comment on any specifics now. But, I think, the overall long-term strategy, you should expect that to continue to unfold.

George Staphos

Mitch, the pace should be fairly comparable from what we've seen over the last few years, not calling it dollar by dollar, quarter by quarter, but no reason to expect that to decelerate over time?

Mitch Butier

Over a couple of year period, yes, individual years can be up or down, as you know.

Operator

Our next question comes from the line of Jeff Zekauskas with JP Morgan Securities Incorporated. Your line is open. Please go ahead.

Jeff Zekauskas

In your LGM business, I think, you said that your organic growth in North America was flat in the quarter. Can you remind me what the trends were in the first two quarters of the year? And, can you talk about why North America is slow?

Mitch Butier

Yes. The organic growth was flat in the quarter overall. And in the first half, I commented that the market overall been growing low single digits, but we did have the share losses that we’ve talked through, within that business. And the market comments I'm saying are on volume, in our growth, I’m commenting on is organic growth. So we had the positive impacts of pricing and negative impacts from some of the share loss and volume.

Jeff Zekauskas

Right. I mean, it sounds like the North America -- is it fair to say that the North American market is slowing down and the Chinese market is accelerating a little bit sequentially, or you can't tell that as it’s more…

Mitch Butier

We don't have data for Q3 yet, Jeff -- sorry to interrupt. We don't have data yet for Q3 in North America. But if you -- from our own market entail and just what we've seen, it seems fairly consistent, just low single digit growth. So, that's our revenue growth as far as volumes. And in China, China had been on a decelerating trend and then started to bounce back here in Q3. Not decelerating to negative, meaning from upper single digit growth for couple of years ago to mid single digit growth to low single digit growth and now -- and then, flat in the first half of the year and now we're starting to see a rebound here.

Operator

Our next question comes from the line of Joshua Spector with UBS Securities LLC. Your line is now open. Please go ahead.

Joshua Spector

Just a question on IHM. So, it's rare we've been hearing about industrial's growth broadly. And you guys printed a pretty good quarter. Just wondering how much of that is an easing comp versus tough comp last year versus real growth in some of those markets.

Greg Lovins

Yes. Thanks. This is Greg. So, overall, I think we -- as you said, we feel good about our performance against the generally weaker industrial backdrop. There is a few areas where in addition to the fact that last year certainly from a comp perspective was when we really started to the China auto market slow. So, that was a year-over-year benefit. But, in addition to that, our medical business, as you've heard us talk about over the last -- really it's fourth straight quarter I guess where we've had growth in the high teens in our medical business. So, that business continues to perform very well and has certainly been taking some share in some target applications. We'll start to lap some of that high teens growth here as we go into the fourth quarter, but feel very good about how that business performed over the last year.

And at the same time, on industrial for us, this is really an application by application based business. And here, we also feel like we want some share and some target applications in areas such as building construction tapes in North America as an example is an area we continue to grow very well in. And so, it's a little bit easier comps in automotive, but still, automotive market as a whole this year or in Q3 was still down, auto production globally, and we did grow in kind of low to mid single-digit range. So, feel good about the performance here, as you said against generally weaker industrial.

Joshua Spector

Okay. That's helpful. And then, on the LGM side, in terms of you guys feeling that you got back most of your lost share, if the market remains kind of tepid here, do you see any risk of more share shifts back and forth, maybe some context than prior cycles with slower general growth, is there a lot of kind of back and forth or price pushes to try to gain volumes back, now that you've kind of got your share again?

Mitch Butier

Yes. Generally, when we see the share moving around, it's usually in periods of change. So, rapid inflationary environments or deflationary environments is when we tend to have seen it, particularly at the beginning or ends of those cycles. So, if we were to go into slow growth, if that's your question but stable environment, we haven't experienced that first the same period of time in our industry. Our industry is more resilient in that. But if we were to, I have nothing in our history to tell us that that would cause more variation in share position.

Operator

Our next question comes from the line of John McNulty with BMO. Your line is open. Please go ahead.

John McNulty

With regard to the margin improvement that you've been seeing from the cost cuts, it sounds like you're going to end the year certainly higher than you started the year. So, I guess, when you think about the year-end run rate for 2019 and how we should think about kind of the improvement that you can see in 2020, without any incremental cuts, I guess, how should we be thinking about what that incremental bridge is from '19 to '20, based on the cost cuts you've already put through?

Greg Lovins

Yes. So, just based on cost reductions, we would expect carryover from a restructuring perspective into 2020 of somewhere in the $20 million to $25 million range. A lot of that’s driven by the European restructuring that we've talked about quite a bit, but that savings really started to kick in at the end of Q2, beginning of Q3 of this year. So, I think we have that as a tailwind going into next year. At the same time, we have some headwinds such as currency translation, which is a headwind for us here in the back half of this year that will be a headwind then in the first half of next year, if we stay at these rates, and a few other items as headwinds, I think as well there. But overall, carryover restructuring about $20 million to $25 million.

John McNulty

Got it, great. And then, with regard to -- I think, you’d said autos were actually up in the quarter. And I guess, we understand that there were some relatively easy comps, but admittedly, you may be the only company we look at that actually had a positive auto number. So, I guess, what's driving that? Is that new vehicles that you are on, is it new applications that you're finding per vehicle, like I guess, how should we think about what's really driving that growth when auto comps are clearly going down?

Mitch Butier

Yes. So, a lot of our auto growth in the quarter actually did come in China where we had some significant clients as we talked about over the past year and before this quarter that that market really slowed. And we saw some -- while that market is still soft overall from an auto production perspective, we did see some of our business start to pick up a little bit in the third quarter. So, that's really been the biggest area of automotive growth here in Q3.

John McNulty

Great. Thanks very much. For the color.

Operator

Our next question comes from line of Anthony Pettinari with Citigroup Global Markets, Inc. Your line is open. Please go ahead.

Anthony Pettinari

In RFID, it sounds like non-apparel opportunities are going better than you initially expected. And I think, in the past you've identified food, beauty, aviation and logistics as kind of four markets that were real opportunities outside of apparel. I'm just wondering if you can provide any color on those four markets maybe broadly and if there's any one in particular where you're seeing customer wins or what customer adoption has been kind of faster than you've expected or anything that surprised you there?

Mitch Butier

Yes. So, overall, the speed at which we've been able to build the pipeline has been rapid. And I don't think we gave projections about what we expected. But, we are hitting our ambitions on that. And as I’ve mentioned, most of the growth in the actual pipeline is for categories outside of apparel. Specifically, the biggest growth driver of that has really been within the food category. So foods, we have quite a few programs in the pipeline that we're working.

As far as the actual growth, the growth levels, it's high in percentage terms but off of a very small base. So, our focus here is, leverage the strengths that we have within the apparel segment, both from a business development as well innovation and manufacturing capabilities, and identify other end markets where there are similarities to apparel that we think are right for adoption that begin to build that. We're having some wins along the way, but a lot of this -- the revenue right now outside of apparel, a lot of them are at the pilot stage and so forth to pilot revenue. And there's a couple of moving to full adoptions, but it's relatively small, less than 10 program. So, a vast majority of the pipeline is still early stage. And for us, it's really the growth opportunity, particularly in the 2021, 2022 beyond is what we're really focused on, as far as when it starts to become much more meaningful numbers.

Anthony Pettinari

And then, just sticking with RBIS maybe more broadly, you referenced uncertainty around tariffs. Did you see kind of a pull forward in RBIS demand, and maybe the first half with Chinese customers trying to buy ahead of potential tariffs on apparel? Are you seeing customers more kind of sitting on the sidelines? Can you say anything about sort of customer inventory levels currently and when they could resume kind of more normal buying patterns?

Mitch Butier

Yes. So, overall, we just saw tentativeness. We've talked about the base apparel business slowing a little bit already, the rate of growth slowing in Q2 already, and it further moderated here in Q3. We didn't see people trying to buy ahead of time, because there was just -- there was tentativeness and people in general were just slow to move overall.

When we look at what's going on, our growth trends and we talk to other players in the segment suppliers, people who provide threads and so forth, what they are seeing is similar to what we are seeing. Now, when you talk about actual at the retail and brand level, you have some retailer and brands that are doing phenomenally well and others that are struggling. So, there is a bit of a mixed bag, if you will, as far as what's going on in retail environment. So, we didn't really see inventory builds or anything, if you look at the inventory trends. Inventories dropped dramatically in '18, built up a little bit at the end of last year, beginning of this year, but then has already started depleting again. And these are levels that are near all-time lows right now, as far as inventory levels, which I think just shows retailers and brands focused on the need for faster supply chains and lower inventory levels in this more uncertain environment, which just further reinforces the adoption of RFID.

Operator

Our next question comes from the line of Rosemarie Morbelli with Gabelli & Company, Incorporated. Your line is open. Please go ahead.

Rosemarie Morbelli

Thank you for taking my question. I was wondering if on LGM you have obviously reached your margin targets, it is a strong level you have. You are done with restructuring Europe. How much more do you think we can see this target improving? I mean, not the target, but the margin itself.

Greg Lovins

Yes, Rosemarie. So, we've set a target of 12.5% to 13.5%. As you said, we are in the upper end of that targeted range. When we set those targets, we had -- last two times we had set long-term targets, we continually raised them and we said that we were focused on -- and we saw the opportunity for more. And so, we expanded them at that time. At this level, this business is – the returns are to multiple of the cost of capital. So, for us, we're not looking to adjust targets or anything for any of our businesses right now, somewhere within them, ones below it, making good trajectory to get it within and another being RBIS is above it. We're not going to adjust our targets or comment on that at this time. When we set our next set of long-term targets, we'll adjust accordingly. But, I think the key message here is we got a good growth, high return business here in LGM that we see, feel great about our position and prospects for.

Rosemarie Morbelli

And then, I was wondering if you could touch on M&A and the potential of seeing something between maybe not now in the end of the year but after the near future?

Mitch Butier

Yes. So, in M&A, timing is always tough to call, pipelines for part of engagements. I will say prices remain stickier for longer than we probably would have previously anticipated. So, we're going to be disciplined as we go through this. Our focus here is disproportionately focusing on areas that will increase our exposure to high value segments. And calling something specifically within announcing in a three, month, six-month period is just too tough to call. So, not going to comment on that specifically.

Rosemarie Morbelli

All right. Thank you.

All right. Thank you.

Mitch Butier

Thank you.

Operator

Our next question comes from the line of Paretosh Misra with Berenberg Capital. Your line is open. Please go ahead.

Paretosh Misra

Great. Thank you. So, in your IHM segment within the medical products, is there any specific product launch or application that is driving the strong growth?

Mitch Butier

Yes. It's pretty broad-based for us across the applications that we continue to grow well in some of our core business. We've also been growing in some of our antimicrobial business, what we call CHD that we've launched over the last year or so. So, we've seen a little bit of growth coming from new products from that perspective, but pretty broad-based across our portfolio over the last few quarters.

Paretosh Misra

Got it. And then a follow-up on the RBIS segment. I think, you mentioned something on embellishments. So, how big is that, and what do you think that growth rate is sustainable?

Mitch Butier

Well, we think this business can grow at a pretty high clip, well above the average, and it's been above 10%, above 20% this year. The business is less than 10% of overall RBIS. And so, it's relatively small. We've been talking about this for a few years and started off from essentially nothing about five years ago, and been growing it, and it's -- but it's still sub 10%. So, we see good amount of opportunities to continue to expand it. This is taking our capabilities, both innovation and product capabilities, as well as our manufacturing presence to basically move from trim and being -- having external -- having embellishments inside the garment, outside the garment. And the key driver for growth right now for us is in the European soccer clubs.

Paretosh Misra

I appreciate it. Thank you, guys.

Operator

Our next question comes from the line of Chris Kapsch with Loop Capital. Your line is open. Please go ahead.

Chris Kapsch

Yes. Hi. Thank you. Just a follow-up on the dynamics around your comments about gaining back market share within LGM. So, you said that -- in the past, you've talked about when these things happen, you tend to lean on superior service and quality more so than price as the means to get back share. Can you just characterize if that's sort of what the tactics have been in this instance, as you said, to gain back the share that you did or be in a position to gain back the share? At least, it sounds like you characterized it that way.

Greg Lovins

Yes. So, primarily, the tactics are if some business moves away for a bit, is be patient and diligent, and we know that we've got superior service and quality, and just continue the dialog with those customers, and eventually the share rebalances. The other thing that happens is, we went from the last price increase when we were at the end of the inflationary cycle to in some areas, some commodities seeing some deflation, so where we saw that we had a relative price premium that was maybe outside of the targeted band that we think a particular product or solution warrants. We will then adjust at that level. So there is some price in there to be focused on being competitive, and that's not broad-based, that's maybe targeted areas. But, the overall focus here is to patient and diligent. We've built tremendous capabilities as far as service and quality, and be confident in that and let it play out for a few quarters.

Chris Kapsch

And if I could just follow up on that, would you characterize the regained market share consistent by region? And then getting more granular on that. Is that enough to explain why the sales growth in Southern Europe and then -- and in North America where you were flat, if you gain back shares that to suggest that the overall market was negative in the quarter? Thanks.

Mitch Butier

So, it's important -- our share gain comments are mostly sequential comments. So, the share gain was not relative so much to Q3 of last year. It's more from the first half of this year. So, when we're talking about market growth, the comments that we made, those are year-over-year. So, the share gain was not a driver of year-over-year growth as much as it was sequential.

Operator

We have a follow-up question from the line of Adam Josephson with KeyBanc Capital Markets. Your line is open. Please go ahead.

Adam Josephson

Thanks for taking my follow-ups. I appreciate it. Just one housekeeping one and one on sustainability. On the housekeeping one, Greg or whomever, can you -- and the Chinese one has strengthened quite a bit in recent weeks, so can you help me with what FX rates you are using for 4Q?

Greg Lovins

Yes. So, our RMB -- sorry, our euro rate is just under 1.10 in the quarter, so I think 1.09 point something in the quarter for the euro; and the RMB is a little over 0.14 for the quarter.

Chris Kapsch

And just on -- Mitch on sustainability, there is a lot of talk about potential shift out of PET bottles toward aluminum, just given CPG companies desire to rid themselves of plastic to the extent possible. Can you just give us your view of this whole sustainability movement and talk about what if any impact you're seeing on your business? I would assume it's negligible just given the types of labels that go on those bottles, but anything more, I would appreciate.

Mitch Butier

Yes. So, the largest primary focus right now is really around single-use plastic containers. And there's varying definitions for what that is. But, if you think of water bottles and straws and so forth, pressure sensitive labels are going very few of those products, and that's where you're seeing a lot of the migration over. In general, my view is, is that there is an appropriate focus on sustainability of packaging in general. It's a key focus of the industry. It's a key focus of ours. We've been -- we're out in front of many companies, especially packagers making sustainability a priority. And I'd say, the first wave of that was more around improving the sustainability of our own business. Dramatically, we've reduced greenhouse gases by 30% over the last number of years, buying more sustainably sourced raw materials such as more than 90% of our paper that we procure is sustainably certified such as for Stewardship Council. So, that is in the focus. And now, more recently, we've been shifting more on making sure that our products make recyclability much more easy and efficient. So, we think this is an overall longer term trend for us. We see this is something more of a longer term drive. We think it's important. We're the market leader. We're increasing our level of investment innovation in this space, because we intend to lead here.

Operator

Our next question comes from the line of George Staphos with Bank of America Merrill Lynch. Your line is open. Please go ahead.

George Staphos

Hi, everyone. Just a couple of questions on topics that come up periodically on your calls that -- regarding displacement types of technologies relative to your core products. So we were at PACK EXPO recently, we saw -- it seemed to us anyway a lot more commentary by some of the other packaging providers around direct printing on secondary packaging, which obviously, if that really took off and it was scalable, would have some threat -- present some threat to labeling and pressure sensitive materials. Mitch, what are you seeing in that regard? Are you seeing a little bit more activity there from competing technologies, are you not? Would you agree with our perception that whether or not it’s a threat, you're seeing a little bit more activity from competing materials and competing technology, I should say? And then, similarly, comes up periodically, are you seeing any increased attempts by brand owners and retailers to not necessarily go down the RFID path, but use other technologies to track product through supply chain, without having RFID, those revision systems or other things like that? Thank you very much, and good luck in the quarter.

Greg Lovins

Thanks, George. Yes. So, specifically, as far as other labeling technologies and commenting on direct print, we've actually been engaging with a number of firms on the direct print for a number of years now. So, we've seen some activity here. The technology we -- what we see as far as the economics of it, is still pretty far ways off. So, we're actively engaged. I think, as number of people are playing with and working through, but it's really going to be in the small volumes premium side of this industry.

As far as the use of other technologies to track products, yes, we've been consistent in saying when we think about the Internet of Things and everything physical having a digital twin, digital life, we've said RFID is one of a number of enabling technologies, and there's a number of areas where wireless radio base connection will be required, others where you maybe have more clear line of sight, less SKU complexity and so forth, will be using other technologies. So, we think there's going be a complement of technologies that enable that future overall. So, that's not -- we're working with a number of those companies and well aware of that and see this is actually a space where multiple technologies will prosper.

Operator

Mr. Butier, there are no further questions at this time. I will now turn the call back to you for any closing remarks.

Mitch Butier

Okay. Well, thank you everybody for joining. Overall, another solid quarter. We're confident in achieving our long-term targets which once again reflects resilience of our industry-leading market positions, the strategic foundations we've laid, and our agile and talented workforce. Thank you.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.