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3M Company (MMM) CEO Mike Roman on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $2.58 beats by $0.08 | Revenue of $7.99B (-1.97% Y/Y) misses by $-205.64M

3M Company (NYSE:MMM) Q3 2019 Earnings Conference Call October 24, 2019 9:00 AM ET

Company Participants

Bruce Jermeland - VP of Investor Relations

Mike Roman - CEO

Nick Gangestad - CFO

Conference Call Participants

Andrew Kaplowitz - Citi

John Walsh - Credit Suisse

Julian Mitchell - Barclays Capital

Andrew Obin - Bank of Merrill Lynch

Steve Tusa - JPMorgan

John Inch - Gordon Haskett

Deane Dray - RBC Capital Markets

Scott Davis - Melius Research

Joe Ritchie - Goldman Sachs

Nigel Coe - Wolfe Research

Laurence Alexander - Jefferies

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the 3M Third Quarter Earnings Conference Call. During the presentation, all participants will be in a listen-only mode. Afterwards, we will conduct a question-and-answer session. [Operator Instructions] As a reminder, this conference is being recorded Thursday, October 24, 2019. I would now like to turn the call over to Bruce Jermeland, Vice President of Investor Relations at 3M.

Bruce Jermeland

Thank you, and good morning, everyone. Welcome to our third quarter 2019 business review. With me today are Mike Roman, 3M's Chairman and Chief Executive Officer; and Nick Gangestad, our Chief Financial Officer. Mike and Nick will make some formal comments, and then we'll take your questions.

Today's earnings release and slide presentation accompanying this call are posted on our Investor Relations website at 3m.com under the heading, Quarterly Earnings.

Before we begin, let me remind you of the dates for our future investor events. Please turn to Slide 2. Our Q4 earnings conference call will be held on January 28th, 2020. Please note we will be providing our 2020 guidance during our January call. As a result, we will not be having a 2020 outlook meeting later this year. Please take a moment to read the forward-looking statement on Slide 3.

During today's conference call, we will make certain predictive statements that reflect our current views about 3M's future performance and financial results. These statements are based on certain assumptions and expectations of future events that are subject to risks and uncertainties. Item 1A of our most recent Form 10-K lists some of the most important risk factors that could cause actual results to differ from our predictions.

Please note that throughout today's presentation, we will be making references to certain non-GAAP financial measures. Reconciliations of the non-GAAP measures can be found in the appendix of today's presentation and press release.

Please turn to Slide 4 and I'll hand it off to Mike. Mike?

Mike Roman

Thank you, Bruce. Good morning, everyone, and thank you for joining us. The 3M team executed well and delivered a strong operational performance in the third quarter, building on our progress in the second quarter, while the macroeconomic environment remains challenging, we continue to effectively manage costs, improve productivity, and invest for the future.

We exceeded the cost savings plan that we laid out in April, at the same time reducing inventory by $180 million. This is on top of the $250 million reduction in Q2.

Our underlying margins were strong, and we generated robust free cash flow with a conversion rate of 106%. At the same time, we are making good progress on our four strategic priorities for value creation, portfolio, transformation, innovation, and people and culture. For example, two weeks ago, we finalized our acquisition of Acelity, which is an exciting addition to 3M's health care portfolio.

In Q3, we also divested our gas and flame detection business and announced the sale of our ballistic protection business, all part of our ongoing effort to optimize our portfolio.

Later in today's call, I will also discuss our guidance for the full-year and provide an update on PFAS. Please turn to Slide 5 for a summary of our third quarter results.

Organic growth company-wide was minus 1%. We continue to face softness in certain end markets, namely China, automotive and electronics, which represent 30% of our company. Growth in the rest of our business was positive. And we saw strength in end-markets such as residential construction, medical and consumer retail, which Nick will discuss.

We also continue to see good returns from our investments in innovation, including the priority growth platforms we have shared with you in the past. Year-to-date, these platforms are up 9% as we create differentiated solutions for customers in areas such as auto electrification, connected safety, and structural adhesives. Turning to EPS, we delivered GAAP earnings of $2.72 per share, a 5% increase year-over-year. Please note that this includes a $0.14 benefit from the Q3 divestiture that I talked about earlier.

We generated underlying margins of 23.8% with all business groups above 23%. For the second consecutive quarter, we improved our margins on a sequential basis while reducing inventory, which shows that our productivity actions are working.

We also saw notable improvements in both EMEA and Canada, two areas where we have deployed our new business processes end-to-end. In these areas, we are seeing improved margins, better use of data analytics, lower inventories and enhanced customer service, which gives us continued confidence in our ability to realize the benefits from our transformation journey.

In summary, I'm pleased with our team's progress in the third quarter. I thank them for their efforts and continued focus as we move forward. That wraps up my opening remarks. I will come back with some additional comments after Nick takes you through the details of the quarter, Nick?

Nick Gangestad

Thank you, Mike and good morning, everyone. I'll start on Slide 6 with a recap of our third quarter sales performance. Third quarter organic sales declined 1.3%. Volumes were down 160 basis points, while selling prices were up 30 basis points.

The net impact of acquisitions and divestitures increased sales by 60 basis points. Well, foreign currency translation was a 130 basis point headwind to sales. All-in third quarter sales in U.S. dollars declined 2% versus last year.

Looking at growth geographically, the U.S. declined 1% organically. Consumer and health care each delivered solid growth in the quarter. This was more than offset by declines in safety and industrial and transportation and electronics. These two businesses were impacted by weakness in end markets and channel inventory adjustments which further softened as we moved through the quarter.

Asia-Pacific declined 4% in Q3, Japan's organic growth was up 3% with broad base strength across most of our businesses. Organic growth was down 9% in China driven by continued weakness in automotive, electronics and export related markets. For the year, we expect organic growth in China to be down mid single digits.

EMEA grew 2% with positive growth across all businesses. Latin America, Canada grew 3% led by strong growth in Canada and Mexico. Please turn to Slide 7 for the third quarter P&L highlights. Company-wide third quarter sales were $8 billion, with operating income of $2 billion. Operating margins were 25.2% which included a 140 basis point benefit from the Q3 divestiture.

Overall, I'm pleased that our actions to drive productivity continue to gain traction with strong underlying third quarter margins of nearly 24%. On the right hand side of the slide, you can see the breakdown of our third quarter margin performance. First, the biggest impact to Q3 margins was the year-on-year decline in organic volume, along with our actions to lower production volumes and reduced inventories to improve cash flow in the quarter.

Partially offsetting these headwinds were benefits from the restructuring actions taken in Q2, as well as net gains related to property sales. In total, these factors resulted in a 160 basis point reduction to margins, versus last year's third quarter.

Acquisitions and divestitures contributed a net 100 basis points to margins, primarily due to the gain from this quarter’s divestiture, which was partially offset by the M*Modal acquisition. Higher selling prices continue to more than offset raw material inflation, contributing 30 basis points to third quarter margins. Well, selling prices came in a bit lower than expected, our sourcing efforts to reduced raw material costs resulting in a net benefit, which we expect to continue as we move forward.

And finally, foreign currency net of hedging impacts increased margins by 80 basis points. Let's now turn to Slide 8 for a closer look at earnings per share. Third quarter earnings were $2.72 per share, which included a $0.14 benefit from this quarter’s divestiture.

Excluding this benefit, overall earnings were solid as the 3M team delivered strong operational performance. Looking at the components of our year-on-your earnings performance, the net impact of organic growth, inventory reductions and the other items that I covered on the prior slide, reduced third quarter per share earnings by $0.16.

Acquisitions and divestitures combined increased third quarter earnings by $0.10 per share versus last year. Foreign currency net of hedging was an additional $0.05 per share tailwind in the quarter. Our third quarter underlying tax rate contributed $0.08 to per share earnings year-on-year.

The lower rate is primarily a function of last year's tax reform and the benefits it created for U.S. based companies with a significant portion of their manufacturing in the U.S. And finally, we reduced average diluted shares outstanding by 2.6% versus Q3 last year, which added $0.07 to per share earnings.

Please turn to Slide 9 for a look at our cash flow performance. As Mike noted, we delivered very strong cash flow in the third quarter. Free cash flow was $1.7 billion with a conversion rate of 106% which included a negative 27 percentage point combined impact from the Q3 divestiture, and cash payouts of previously accrued respiratory related legal settlements. For the full-year, as a result of increasing cash flow, we are raising our expectations for conversion to a range of 105% to 110% versus 95% to 105% previously.

Third quarter capital expenditures were $349 million and remain on track to be in the range of $1.6 billion to $1.7 billion for the year. During the quarter, we paid $828 million in cash dividends to shareholders and returned $142 million to shareholders through gross share repurchases.

Please turn to Slide 10, where I'll summarize the business group performance for Q3. I will start with our safety and industrial business, which declined 3.3% organically in the quarter. Similar to the first half of the year, we saw continued end market softness and channel inventory reductions, which impacted most of our portfolio.

Looking geographically, safety and industrial’s organic growth was led by a 2% increase in EMEA and a 1% increase in Latin America, Canada. Well, the U.S. and Asia-Pacific each declined.

Safety and industrials third quarter operating margins were 26.8%, which included a 3.9 percentage point benefit from the gas and flames detection divestiture. Overall underlying margins in this business were solid in the quarter when considering negative organic growth and inventory reductions.

Moving to transportation and electronics. Third quarter sales were down 3.4% organically compared to last year. The electronics related businesses declined high single digits organically, as demand remains soft in consumer electronics, semiconductor and factory automation end-markets.

Our automotive OEM business was down 3% in line with third quarter global car and light truck builds. Advanced Materials grew mid single digits organically well both transportation safety and commercial solutions each grew low single digits.

Geographically, Latin America, Canada grew 7%, EMEA was up 1% organically. Well, the U.S. and Asia-Pacific each declined mid-single digits. Transportation and Electronics third quarter operating margins were 25.2% down 250 basis points. Similar to safety and industrial, margins were impacted by lower sales and inventory reductions.

Turning to health care, the business delivered 2% organic growth in Q3. Organic growth was broad based across most of our health care business. Growth was led by a high single digit increase in Health Information Systems. We continue to invest in this business, including this year's acquisition of M*Modal, which recently launched a new AI clinical documentation software that provides real time insights to clinicians. Medical Solutions, our largest business in health care was up low single digits in the quarter. We are excited to have Acelity join this team, which Mike will cover shortly.

Food safety grew organically mid-single digits with oral care up slightly. Separation and purification was down mid-single digits, primarily due to softness in China. Looking geographically, health care grew across each area.

Health care's third quarter operating margins were 26.7% impacted by 1.5 percentage points from the M*Modal acquisition. Also impacting margins were inventory reductions, Acelity acquisition related costs and investments in priority growth platforms.

Lastly, third quarter organic growth for our consumer business was nearly 3%. Sales were led by

mid-single digit growth in home improvement and low single digit growth in consumer health care. Well stationery and office and homecare declined.

We saw continued strength in many of our leading brands in particular Filtrete, Command and Nexcare. Looking at Consumer geographically, EMEA, Latin America, Canada and the U.S. each grew low single digits, while Asia-Pacific declined.

Consumers operating margins were 23.2% in the third quarter up slightly year-over-year. That wraps up our review of third quarter results. Please turn to Slide 11. And I'll hand it back over to Mike. Mike?

Mike Roman

Thank you, Nick. I would like to make a few comments about our acquisition of Acelity, which was finalized earlier this month. We are excited as we bring together two innovative companies focused on improving health care outcomes for patients. Acelity offers an impressive range of medical solutions, including their groundbreaking negative pressure wound therapy.

They are an ideal fit within our health care portfolio, complementing our existing business and further accelerating 3M as a leader in advanced wound care, which is a significant and growing market. Acelity has annual revenues of $1.5 billion and year-to-date, they have delivered organic growth of 5% and EBITDA growth of more than 10%.

We look forward to leveraging the fundamental strengths of 3M, especially our global reach and technologies to build upon these results and drive even greater value. We expect the acquisition to be $0.25 dilutive to GAAP EPS in the first 12 months or $0.35 accretive excluding purchase accounting and anticipated one-time expenses related to the transaction.

We are pleased to welcome the talented people of Acelity to our 3M team and are confident in the value this acquisition will deliver to our customers and our shareholders. Please turn to Slide 12 where I will discuss our guidance.

Today we are updating our guidance to incorporate the Acelity acquisition along with our expectation of continued softness in China, automotive and electronics. With one quarter remaining in the year, we are providing our guidance for Q4.

We anticipate earnings in the range of $2.05 to $2.15 and an organic sales decline of 1% to 3%. On this slide, you will also see our updated full-year guidance for EPS and organic growth. Before turning to Q&A, I would like to make a few comments related to PFAS. We continue to proactively manage this issue. And I would like to provide some specific updates of what we have done since our last earnings call.

As you may know in early September, we testified before Congressional Subcommittee in Washington D.C. We reminded the committee that the weight of scientific evidence does not show that PFAS cause adverse human health effects at current or historical levels. Opposition shared by public health agencies and independent science review panels. In our testimony we also announced a number of commitments that build upon our existing efforts related to PFAS including supporting new coordinated research into PFAS, establishing a clearinghouse to share best practices on detection, measurement and remediation, supporting nationwide science based regulation and continuing to work with former customers to help ensure that unused AFFF containing PFOS is properly handled.

We also reaffirmed our commitment to ongoing remediation of our manufacturing facilities and historical disposal sites. With respect to litigation, the AFFF multi-district litigation is still in the early phases and at this time no trials have been scheduled.

Outside of AFFF, the earliest we expect other product related trials to begin would be in the Spring of 2020.

Moving forward, we will continue to keep you updated as developments unfold. In summary, as I look across our company, I see the strength of the 3M model. We have deep competitive advantages in our unique technology platforms, advanced manufacturing, global capabilities and leading brands. We also have experienced teams that know how to manage through macroeconomic slowdowns, which our businesses tend to see early. In these situations, we put an even greater emphasis on improving our operational performance and reducing costs, enabling us to generate strong cash flow as we did again in the third quarter.

And throughout the business cycle, we remain focused on winning with our customers and keeping them at the core of everything we do, a great strength of the heart of the 3M culture.

As a result, we are well positioned to lead out of this slowdown, and deliver strong growth and premium returns as our markets recover. Thank you for your attention, and we will now take your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of Andrew Kaplowitz with Citi. Please proceed with your question.

Andrew Kaplowitz

Hey, good morning guys.

Mike Roman

Good morning, Andrew.

Andrew Kaplowitz

Mike or Nick, can you give us more color into your revenue guidance for Q4, if you look at sales comps. They're reasonably close to Q3 and Q4, you are forecasting continued deceleration at the mid-point of your guide, so you are expecting some of your markets just still get worse in Q4 and could you give us some color by segments are the biggest changes there in safety and industrial, and then in health care, are you going to reach the high end of your range. And how much of that is the China slowing that you mentioned?

Mike Roman

Andy I would say when you look at Q3 versus Q4, Q4 has a very similar dynamic to Q3. You start with industrial production GDP, they're pretty much in line quarter-to-quarter. We, as I said in my remarks are still anticipating some that slowing in China automotive and electronics could continue through Q4. So that outlook continues to remain the same. I would say our view of Q4 is on the top line, much like Q3 and with a range around it.

And then we are and our focus continues as you expect to focus on execution. There are growth opportunities, that 70% that has positive growth in Q3, there are growth opportunities there, so we're going to be pursuing those aggressively and there are much of health care as part of that.

Andrew Kaplowitz

Okay, Mike and maybe shifting gears, Nick, can you give us more color and how you're thinking about all the moving pieces around margin obviously good performance in the quarter, you got to around 23% in Q3 and you came in closer to 24% ex-divestiture. So you talked about second half restructuring, currency tailwind lessening impact from inventory destock. And then you've got the transformation optimization ramping up. So can you talk about which of these variables were better than expected? And if it's possible, could you give us some early color and how you're thinking about these variables into 2020?

Nick Gangestad

Okay, Andy, quite a bit you asked there. First of all, we are I am very pleased with our margin performance in Q3. When we strip out the gain on our divestiture nearly 24%, and we're seeing productivity actions that we’re taking gaining traction.

And at the same time, we're continuing to lower our production volumes and inventories with our focus on improving cash flow. So very pleased with that. Now when we look at what's going on in the margin performance itself in the quarter, there's about 150 basis points that we lay out that's negatively impacted from organic growth, inventory reductions and other items and about a third of that headwind is just directly related to the lower organic growth.

And then the remaining two-thirds is tied in with our lower production on lowering our inventory levels. And it is partially being offset and being benefited by our restructuring actions, which are coming in exactly as we expected. And we also had a gain on a sale of some property that will just go into a little more depth on. We continue to do have a portfolio process where we're reviewing our assets that we have in place looking for are they optimal?

And can we be moving to more cost effective operations, we continually do that. And then in the third quarter, we consummated a transaction disposing of an office building that resulted in a net benefit of about 50 basis points to our margin, or about between $0.06 and $0.07 per share. So those are the main things going on in the quarter from a margin perspective. If I as far as next year, Andy, I think it's really too early. We're so focused on delivering 2019. We'll give guidance on that in January.

Andrew Kaplowitz

All right, thanks Nick.

Nick Gangestad

Yes.

Operator

Our next question comes from the line of John Walsh with Credit Suisse. Please proceed.

John Walsh

Hi, good morning.

Mike Roman

Good morning, John.

John Walsh

I guess, maybe going back to electronics and automotive markets, maybe even China as well, in the Q, you have the reported numbers, you kind of give us some direction on the local currency growth on the call, but are you actually seeing the second derivative start to improve in those end-markets. So if you look at some of the external data, electronic markets declines have kind of stabilized, at least where they are in terms of negatives and gotten a little bit better sequentially, auto could potentially flip next year as second derivative gets better, but can you talk specifically to your businesses and those that touch those markets, what you saw in the quarter?

Mike Roman

Sure John. Yes, just maybe kind of look across all those starting with automotive, so automotive the build rates are still negative and actually, I would say, the projections, they were worse than the projections maybe bit better than what we saw in the first half but still negative and so that was something that is an update to how we look at the second half of the year, I think we had a more conservative view of the overall projections.

And so we are planning for this. We did see additional channel reactions to those negative build rates. We had talked about in the Q2 call that we thought a majority of the channel response to the decline in automotive and electronic more broadly took place in the first half of the year, but we did see some additional adjustments, a big part of that in I would say in China, but more broadly than that as well.

Electronics continued to be a drag in terms of end markets, they were negative growth as well. There's some signs out there that people are optimistic it’s going to improve. We have some early indications that semiconductors is looking like it might start to improve. Certainly there's been some good consumer electronics, OEMs and brands that have talked about increasing sales. We've yet to see that necessarily play through the supply chain for us, but it's, I think the Q3, Q4, what I said earlier to Andy's comment, we see auto electronics and China kind of in line between Q3 and Q4.

So we haven't seen that what we call a bottom and an upturn yet, although there are some signs in electronic side anyway, that there's an outlook for improvement coming.

John Walsh

Okay, thank you for that. And then I guess as we think about at least the acquisitions and I know, you don't want to get into next year, but maybe we can talk about the underlying you're seeing in the back half this year, obviously M*Modal will flip from being a headwind to a tailwind based on your prior guidance for that business. We have Acelity coming in, but can you talk about the underlying health care business either in terms of incremental, if you were to take out all the noise, are you seeing anything different than history? Or maybe just help us understand what's going on there in an underlying basis?

Nick Gangestad

Hey, John, just to clarify you’re talking about growth or margin when you're saying that?

John Walsh

Sorry, on the margin side, on the margin side, because there's going to be a lot of noise in that margin number, particularly on Q4 through the acquisition dilution.

Nick Gangestad

Yes, thanks for clarifying that, John. So what we're seeing in health care, from year-on-year margin performance, the biggest thing as I said earlier is coming from our M*Modal acquisition and yes, that will start to flip next year. Other things going on there, we're continuing to invest in a number of priority growth platforms. If those are a number of growth platforms that you've seen us lay out and health care has a disproportionate amount of those and we continue to invest in that.

We also in the current quarter is some investments we're making as we get ready for the Acelity, as we were getting ready for the Acelity acquisition, that that's, that's part of that. Just from a historical standpoint, we reorganized this business earlier this year, and added our separation purification business to be part of this. And I think, John, we restated and shared with those were on a restated basis for last year and the year before that, the health care business was operating on about a 28% operating income margin.

John Walsh

Great, thank you for that.

Operator

Our next question comes from the line of Julian Mitchell, Barclays. Please proceed.

Julian Mitchell

Hi, good morning.

Mike Roman

Hey, good morning.

Nick Gangestad

Good morning, Julian.

Julian Mitchell

Good morning, maybe just starting with the health care division, not so much on the margin side, which I think you've clarified that maybe organic growth. So I think the organic growth year-to-date in health care is running at about 2%. Also, just wondered, when you're looking at that, maybe over the next 12 months, what are you expecting to accelerate that number and related to it separation purification rolled over, it sounded like having been flattish in Q2. How long do you expect that downturn to last and maybe tied to health care? The Acelity GAAP dilution has shrunk a bit versus what you said at the time of the deal. What drove that?

Mike Roman

So, Julian, I would start with just this remains a very attractive business, the end markets are very attractive with some strong growth trends, the demographics play well here.

So, as we look forward, we see that as a strong growth driver for us. If you look in the quarter that the 2% growth, it was positive across nearly all of health care and it was led by good growth again in Health Information Systems and food safety, strong growers. Medical solution was up low single digits. The headwind that we faced with separation and purification, as you talked about, and that was primarily due to elevated channel inventories in a few areas of the world.

And one of those is China, where we have a significant separation purification business, so that was the headwind, we did have both drug delivery and oral care. We're up slightly in the quarter and we expect drug delivery to continue to improve sequentially as we go forward and oral care continues to grow strongly, globally we saw some softness in the U.S. And we think the strength globally will carry us to better growth as we move ahead.

So the overall markets have strong portfolio and the medical solutions business getting stronger with the integration of Acelity. By the way, the results in health information are reflecting some of the early synergies that we're getting from our M*Modal acquisition bringing those teams together that's really starting to play out in the market for us as well with our customers. So I think we do see it improving as we go into next year.

Nick Gangestad

And Julian in regards to the improved guidance that we're giving in regards to Acelity, we had previously said that in the first 12 months, we expected it to be $0.35 dilutive to GAAP earnings and we now expect it to be $0.25 dilutive in the first 12 months to GAAP earnings. That's $0.10 better EPS impact is primarily related to lower than expected financing costs.

We saw interest rates from the time we announced that to when we actually obtained that financing improve. That's one piece and the most significant piece, we also are seeing better than expected EBITDA projections for that business than we were assuming back in May when we announced this deal.

Julian Mitchell

That's good to hear. Thank you, Nick. Maybe one quick follow-up switching tack, just looking at the firm wide P&L for Q3. Very good performance on SG&A to sales coming in at 18%. Just wondered how much you thought that was sort of variable costs, or something temporary, like currency affecting that number or that ratio and how much is related to fixed cost reduction efforts that Mike you've been putting in place the last 12 months, and whether that sort of lower SG&A to sales run rate may be sustainable.

Nick Gangestad

If I look at this year-on-year, third quarter last year to third quarter this year, we're down about 80 basis points year-on-year. That's the combination of a couple of things. First of all, FX is not having a very material impact on that on as a percent of revenue, because it's, it affects both the numerator and the denominator, not a big change there.

The two biggest things, Julian that are impacting that. One is the restructuring actions that we took in second quarter, we're seeing that benefit, the second and that that I see as sustained. The other thing that's impacting that is the gain we had on the sale of the building that I mentioned earlier, that that will not be a repeated action. It's about half and half.

Mike Roman

And Julian I would just as Nick said, we're executing well against our plan for the restructuring actions. Our teams are also responding to the dynamics that we see in the market and I think you see good operational and cost discipline as part of every business. So those are both playing through.

Julian Mitchell

Great, thank you.

Operator

Our next question comes from the line of Andrew Obin with Bank of Merrill Lynch. Please proceed with your question.

Andrew Obin

Yes, good morning.

Mike Roman

Good morning, Andrew.

Nick Gangestad

Good morning, Andrew.

Andrew Obin

And just a question, sort of another broad question on growth, as we think auto probably will remain a headwind, specifically North America and even if China bottoms into 2020. Just wondering, what kind of set of macro assumptions do we need for 3M to grow top line organically in 2020? Overall, I'm not asking for your forecast. But if you could just outline what's the baseline macro scenario that gets 3M growing in 2020? Thank you.

Mike Roman

Andrew I'm probably not ready to get the forecast. But I would say what you talk through just automotive electronics and you think about broader across what we've been talking about in our businesses, absent a recession and or some other major downturn in the markets in 2020, we expect to have positive growth across the company. You'll see know, at least in a year-over-year comparable improvements, less headwinds in automotive and electronics. As I talked about earlier, we're seeing some early signs that we might have some upside in electronics going forward, though, that has to play out.

Right, we are focused on Q4 and Q4 will tell us a lot about what to expect certainly in early 2020. But absent a recession, we expect to have positive growth.

Andrew Obin

And just a follow-up on electronics, historically, you guys have been very good at calling out electronics a lot better than other suppliers into the industry. Seems it was one area of the shortfall in the quarter. Can you give us more specifics as to what sub segments within electronics end market. And I'm, looking at one of the slides where you give the full blown disclosure, what specific end markets or products drove deceleration of this quarter versus previous quarter? Thank you.

Mike Roman

Maybe I will talk about…

Andrew Obin

In 18, I'm referring to Slide 18.

Mike Roman

Yes, I will talk about the four end markets in electronics broadly that are -- that we talked about when we talked about driving our growth, consumer electronics, we saw softness in that, continue to come through in Q3. Factory automation, there's no sign that that's turning around at this point, and that that also remains soft. Auto electrification, we saw lower build rates in Q3 in electric, in automotive electrification related platforms and make some models and so that was impacted by the overall auto build rate.

And so that was that we still had some growth in our auto electrification portfolio, but not as strong as we had seen earlier in the year. And then semiconductor, I would say it declined into the quarter but as I said, there may be some early signs that we'll see that pick up as we go forward. So, that's kind of the view of the four. So literally three of them were soft in the quarter and our frame is to, that's the outlook for Q4 as well.

Andrew Obin

Terrific. Thank you very much.

Operator

Our next question comes from the line of Steve Tusa with JPMorgan. Please proceed with your question.

Steve Tusa

Hi guys.

Mike Roman

Good morning, Steve.

Nick Gangestad

Good morning, Steve.

Steve Tusa

So given you aren't going to do the kind of a year-end meeting, will there be a point where you guys kind of it just seems to me like a lot has changed since we last kind of sat down and walk through the strategy like a little less than a year ago. Will there be a time here in the next six months or so and certainly in the context of like maybe what you might learn on the PFAS front, where we'll kind of all get together and reset kind of the long-term view or are you still of the view that, steady as she goes, there's really no change to kind of the longer-term framework and algorithm you provided, last fall or winter, whatever that was in Minnesota?

Nick Gangestad

Yes, Steve certainly the first year of our five year plan hasn't turned out as we anticipated, and given the slowdown in those key end markets, we've been talking about. We do have parts of our five year plan that are just as a reminder are doing well. We're on strong are on track for strong performance in free cash flow conversion and return on invested capital, but you're talking about growth when we look at growth in the outlook. Our Q4 earnings calls where we'll give an outlook for next year which is really the next indicator of where we are to get back on track with the longer five year plan. It's I think we are taking the right actions, I think it's early to today to give an update on the five year plan, but we'll be looking for the right time to do that as we come out of our guide for next year.

Steve Tusa

Okay, so there's no like you're still kind of a, hey we'll see what happens here. And we may or may not reset that. I mean, is there a chance that you'd look at that? Or is there basically no chance that this is basically just a cyclical element in your first year and you will assume everything kind of bounced back?

Mike Roman

We're always looking at the long-term plan versus what we see in the markets, and I think as we get a better view of 2020 we will incorporate that and then we'll come back to.

Steve Tusa

Okay, and then just one last thing on the -- on kind of the leverage the core underlying leverage. I mean, I appreciate you guys had you know some pretty significant inventory headwinds. It still seems to me, especially with the property sale, that there's a bigger decremental kind of volume impact even when you strip out the impact of inventories, is there anything that kind of changes that over the next couple of years? Are you guys spending more than you would otherwise be spending in kind of a tougher environment?

I mean, how do we think about the type of growth you guys need to have, that kind of 40% incremental margin or some real leverage on the margin as things come back up because it looks to me like the decremental leverage remains a little bit tough when you strip out everything but volumes?

Nick Gangestad

Yes, Steve when part of our year-on-year comparison is as you noted, aggressively pulling out inventory out of our own supply chain, we're estimating year-on-year that's having a 150 to 200 basis point negative impact on our margins. So to partly answer your question reaching a point of more stability on our amount of inventory in production that we have in our supply chain. That in itself is in the future going to start to create some of a tailwind to us when we've depleted that inventory out. And by the way, we in our guidance here, we're estimating that we're going to take about another $50 million of inventory out of our supply chain in the fourth quarter.

Steve Tusa

Okay, and then one last quick one on price cost? Is that that material benefit, that's kind of like, detached from volume, right? So like volume goes down, obviously your materials are going to go down, or is that how does that kind of reflect that dynamic? Just remind me about, just remind us of that?

Nick Gangestad

Yes, that's detached from volume. That's looking at what we're getting from prices versus what we're paying for our raw materials. And we really don't factor in a volume component to that.

Steve Tusa

Yes, okay. Great, thanks for all the details. You guys were very helpful.

Nick Gangestad

Thanks.

Operator

Our next question comes from the line of John Inch with Gordon Haskett. Please proceed with your question.

John Inch

Thanks. Good morning, everybody.

Nick Gangestad

Good morning, John.

John Inch

I just want to pick up on the point of the year-end meeting, is this just a suspension for this year based on economy or an influx, or this permanently you're not going to hold these anymore? And so I'm actually curious, how do we get our gift bag of stocking stuffers?

Mike Roman

Well, John, it’s definitely we think it's the right thing to do this year. So we have a really clear

view of what we saw in the quarter as we start the year. We think we can give a better outlook at the earnings call. We did it last year, too. And the dynamic was similar. We saw changes in the end markets coming and we thought it was a better place to give, I think just better quality outlook for the year. So we're going to do it again this year.

John Inch

Yes, I don't disagree. Honestly, November last year was a little early. Just based on the way things were fluctuating, that is not really that much of a surprise. I do want to ask you though, the U.S. did seem to step down in the quarter kind of versus that trajectory and not sure that we're hearing that really from other companies. So I'm curious, kind of what's your read Mike and Nick, on the U.S., what kind of got worse? Was there some inventory? Is this transitory or, what's kind of going on in the underlying and Asia also seem to get a little worse too, but I think you sort of explained that with the additional inventory step down that kind of occurred in some of those end markets, but what's going on in the U.S.?

Mike Roman

Sure, John. IPI as I said earlier, IPI is kind of similar Q3 to Q4 worldwide, but the U.S. we saw significant decline in IPI and a revision down into third quarter and Q4 actually is projected to go negative. So you're seeing a broader impact on industrial production, broader manufacturing, we're certainly seeing that and that's impacting our safety and industrial business, our auto businesses is certainly caught up in that.

We have good growth areas in much of health care. There's some segments, consumer and retail spending continues to be strong in the U.S. And there's some other segments like construction where we've seen significant growth opportunities, but that broader industrial manufacturing set of markets is weighing on the U.S. results. And then we saw with that slowdown, we saw additional channel actions in the quarter. And so that was part of what you saw coming through our numbers, especially our safety and industrial business.

John Inch

And I'm assuming I mean, obviously, we all saw the September I assume print, I'm assuming everything you've seen thus far in October doesn't is the trend since September kind of more or less the same with respect to the United States or is there any other, is there any difference thus far realize that you still got another week to go but?

Mike Roman

Well, I would say as we've talked in the past channel tends to react pretty quickly. So we it's early days in October, we'll see if there's additional reaction there, but I think I would say what I said earlier that Q4 and Q3 kind of in line and October starting out as expected.

John Inch

And then just lastly, Nick on the $0.35 of Acelity accretion, how much like how should we spread that there's obviously going to be some in the fourth quarter through the next four quarters. How would you spread that? And then what about the restructuring savings that we took in the second quarter from those actions? How much hit the third quarter? And how would you expect, again, sequentially the restructuring savings from your second quarter actions to play out?

Nick Gangestad

So the restructuring savings, just as a reminder, we expected an annualized benefit of $225 million to $250 million where we expect $110 million of that to be impact the second half of this year, and that's playing out as we expected and it's almost evenly split between Q3 and Q4. And then the balance of that we expect to benefit the first half of 2020. That that's in regards to the restructuring. As far as Acelity and now you're on to, you're not talking about the GAAP impact, but now from a $0.35 once we exclude the purchase accounting and the transaction and the integration costs, we expect that a large chunk of that's going to be hitting in Q4 right now, all we’ve guided, we expect about $0.15 on a GAAP basis, but on a non-GAAP basis, we're not providing guidance yet. But of that $0.35, we will be seeing that more evenly spread over the next four quarters.

John Inch

Maybe the point is the fourth quarter what how much of the fourth quarter been as Acelity, is that $0.15 of your fourth quarter guidance?

Nick Gangestad

Yes, from a GAAP perspective, it's a $0.15 headwind to us in the fourth quarter and then another $0.10 headwind in the first three quarters of 2020.

Mike Roman

Yes, John that is included in our guidance.

John Inch

Yes, okay. All right, we will work details offline. Thanks, guys. Appreciate it.

Mike Roman

Thanks.

Operator

Our next question comes from the line of Deane Dray with RBC Capital Markets. Please proceed with your question.

Deane Dray

Thank you. Good morning, everyone.

Mike Roman

Hey, good morning, Deane.

Nick Gangestad

Good morning, Deane.

Deane Dray

Hey, I'd like to circle back. I know inventory has come up multiple times during this call. But maybe you can just clarify the interplay here, you're referring to customer channel inventory adjustments, and we've seen this multiple quarters now you called it out with safety and industrial, just because of lower demand, it gets reflected in your organic revenue growth. So we get that but then, as 3M, you're also taking inventory down.

You did $180 million this quarter, you said there's another $50 million. The interplay between the two, how what inventory you actually taking down is all worth the result of lower customer demand? And then Nick, help us understand the cash flow impact as you liquidate this inventory?

Nick Gangestad

Yes, Deane this is impacting our cash flow positively. And it's the single biggest driver, while you're seeing us increase our estimate of cash flow generation for the full-year, as we're realizing these benefits of reducing inventory within our own walls. Some of that is in response to what we're doing, responding to what we see a lower, lower demand right now.

So that's, that's part of it Deane, but part of it is also that we're seeing opportunities for us to be managing our own supply chain more effectively. And that was part of what we've talked about for the last few years around business transformation. I would say we are starting to see some of that benefit. And that's part of the reason why we have this confidence that we can be bringing down our inventories and improving the cash flow as you're seeing.

Mike Roman

Deane, I would add that and we had a plan coming into the year to take down inventory significantly. And follow on to our go live in the U.S. last year, August. We have built inventory ahead of that. We talked a lot last year about what customers did Q2 to Q3, but we built inventory to manage through that. We didn't take all of that out by the end of 2018 and had a plan to do that in 2019. And so what you're seeing part of significant part of what we're doing is that plan and executing it while we see a slowdown and are having to manage our operations against that slowdown.

Deane Dray

That clarification was very helpful. And just as a follow-up, I know there was some SG&A questions but it also looked like corporate costs came in lower. Was that all, was real estate gains there and then interest also looked lower and what were the dynamics there?

Nick Gangestad

The real estate gain that was all in corporate Deane, you're correct on that. As far as interest expense, the total net interest expense came in slightly lower and this will be the last what I'll say low quarter for a while be and this is part of the $0.15 guide. We're saying on Acelity because late in the quarter we issued more debt and we'll be seeing our interest expense increase in the fourth quarter. So we ran, I would say pretty steady interest expense over the last three quarters, we will be seeing that uptick in going into Q4.

Deane Dray

Thank you.

Operator

Our next question comes from the line of Scott Davis with Melius Research. Please proceed.

Scott Davis

Hi, good morning, guys.

Nick Gangestad

Good morning, Scott.

Mike Roman

Good morning, Scott.

Scott Davis

Is there any color you can give us an how the rating agencies view the PFAS overhang, do they circle a number around it and that's called one turn of debt or something like that and just, or is it just not? We're just not far along enough along on that yet?

Nick Gangestad

Scott, I described it as I'd say both our rating agencies as well as everything else -- everyone else on the equity side as well is interested in what that that will be, it's something they're watching, and monitoring just as we're monitoring, I'm sure same as your monitoring as well, but there's not a specific thing that I know of that they're building in their estimates for that for our rating.

Scott Davis

Okay, and I have and cycle timing is always tough, but you're taking down inventories now and then, presumably, sometime in 2020 things get better. I mean, is there a top line impact? Do you think missed orders or risk at all in the inventory plan? Or is it just or inventory so high that it's just, it's just not an issue?

Mike Roman

Yes, Scott, I would say, really what I was talking about this, this big part of our inventory actions this year are follow-on to our go-live in the U.S. and that we don't see that impacting our service. That's getting us back to where we should be. And I would say we what I highlighted in EMEA and Canada as we get deployed end-to-end, we actually see additional benefits and we can get more efficient and manage cycle times differently and days of inventory outstanding will go down and service will go up. And so we're seeing that kind of virtuous combination. So I don't nothing we're doing is putting at risk service. And I would say it's a indication that we're moving forward and getting a position to have better service at lower inventories.

Scott Davis

Are the customers holding less inventory to your mind?

Mike Roman

Well, when you go through distribution across a number of our models, they're all getting more efficient, they're driving out structure and cycle time as well. So I think some of what you see in inventory reductions in the channel is just them driving more efficient models.

Big part of it this year is the slowdown in the end markets. But in general, I think you're seeing all supply chains get more efficient, at least the ones related to us. We are seeing them get more efficient inside our four walls and then with our channel partners as well.

Scott Davis

Okay, super helpful. Thank you.

Operator

Our next question comes from the line of Joe Ritchie with Goldman Sachs. Please proceed with your question.

Joe Ritchie

Thanks. Good morning, guys.

Mike Roman

Good morning, Joe.

Nick Gangestad

Good morning, Joe.

Joe Ritchie

So maybe my first question, just touching on the decremental margins. I think, Nick in your prepared comments, you highlighted the good decremental in safety and industrial. And I'm just trying to figure out the divergence between the decrementals in that business versus the decrementals in the transportation and electronics business. And so any insight that you can provide on either how much of that is either mixed or end-market specific as to as opposed to how those businesses are being run, and how to think about those decremental margins moving forward?

Nick Gangestad

As far as the decrementals between SIBG versus TEBG that I think there's a lot of things in common, Joe actually more than what they're different where they're both seeing volume reductions impacting them as well as taking inventory. And as well as taking inventory out. On the TEBG side, there is also some mixed benefit that's impacting the TEBG numbers a bit more than the SIBG numbers, partly from the geographies in which TEBG sells as well as the businesses where we're seeing the growth versus negative growth this quarter.

Joe Ritchie

So is it is it fair to assume that as things, things stay negative for the next couple of quarters? The decrementals then in the transportation and electronics business should remain kind of at pretty high levels. Whereas, you'll be you'll be able to manage safety and industrial a little bit better?

Nick Gangestad

Yes, over time Joe, as I'm sure you've observed this to TEBG will have higher incrementals and higher decrementals partly given the fixed asset base that we have there that when things are going up, we tend to see a lot more of that fall to the bottom line and when things are going down, we'll see more of that, that flow. So it'll tend, it will follow what's happening with our volumes in the coming quarters Joe.

Joe Ritchie

Okay, fair enough. And then Mike, maybe one question for you, as you kind of think about things on a higher level, not too long ago, you guys performed a strategic review of the Health Information Systems business. I'm just wondering, given what we're seeing in the markets today, is there another thought to kind of look across the portfolio closer to see, if there's any opportunity from a divestiture standpoint?

Mike Roman

Joe, we are always evaluating our portfolio. It's an ongoing process. It's one of the things as we built to become a more active Portfolio Manager, it's really become an active ongoing process and we're focused in that, as I've shared in the past that we're focused on optimizing the value of our portfolio, on an ongoing basis and looking at everything from what we do with our organic investments to where we focus our acquisitions, and what we do with to optimize all parts of our portfolio, including divestitures. And we showed examples, again, where we were, when we identified parts of our portfolio that we could create greater value by divesting them, we're ready to take those actions. So I think it's, I think of it as a very active portfolio pipeline on an ongoing basis and something we top priority for us.

Joe Ritchie

Okay, thank you.

Operator

Our next question comes from the line of Nigel Coe with Wolfe Research. Please proceed with your question.

Nigel Coe

Thanks, good morning.

Mike Roman

Hey Nigel.

Nigel Coe

Hey, Nick, could we just go back to the inventory impacts. I think you said 150 and 200 basis points. So was that $150 million, $200 million, please clarify that?

Nick Gangestad

That was 150 to 200 basis points impact based on our year-on-year change in inventory levels and throughput that we're putting to our factories.

Nigel Coe

Yes, okay, can we just dig into that because that implies a $500 million gross margin impacts, just based on the 150 on revenues. And theoretically, that comes back in 2020, as you think about inventories, but it seems like apples for apples, you're cutting inventory by about $400 million excluding disposals. So I'm just wondering how on earth, it can be as big as that impact just because of the fixed costs absorption. So maybe just kind of clarify that point please.

Nick Gangestad

So Nigel, part of that analysis is looking at how much we built inventories in the third quarter of 2018 compared to how much we reduced inventories in the third quarter of 2019. And in the third quarter of 2018, we were still building inventories fairly substantially. And that's now slipped. So all of that 150 to 200 will not pull forward into 2020 because some of it is a statement on the benefits we were getting in 2018.

Nigel Coe

Got it. Okay, that helps. We'll take it offline on that one as well. And then you kind of alluded to this in the answer to I think Joe's question on the geographic mix location of the sales and you're growing in EMEA, which is your lowest margin regions still, you're declining heavily in Asia, which is your highest margin, so maybe just address the mix impacts that you're seeing right now on margins?

Nick Gangestad

Yes, so some of our businesses and that as we look geographically, Asia-Pacific is one of our higher margin places. And EMEA is one of our lower margin places, so geographic mix is having an impact on us. On the EMEA side, you're accurate in saying, it is our lower margin parts of the world. However, I will point out and thanks for bringing that up. We've been on a journey of rate increasing our margins there. And we are very pleased with the progress we've been making in 2019 on our progression to moving our West European margins up to 20%. 2019 has been a substantial step towards reaching that by 2020. And we were highly confident will be there by next year.

Nigel Coe

Got it. And then just one quick one, Nick, on the FX hedge the eight basis points of impact this quarter. How does that evolve going into 2020? Do we flip into a slight negative in 2020 means any views on that?

Nick Gangestad

It depends on whether you're asking about margin or EPS. We continue to have a number of unrealized gains that if currencies stay where they are. We'll see those gains flowing through in the next two years from our hedging. Right now, I'm not willing to say whether I think it's going to be a benefit or not because there's just too much volatility in the FX market to say but if you look at our 10-Q that we'll be issuing, we lay out here is the amount of unrealized FX hedging gains that we will unwind in the next year or two.

Nigel Coe

Fair enough. Thanks very much.

Operator

Our last question comes from the line of Laurence Alexander with Jefferies & Company. Please proceed with your question.

Laurence Alexander

Good morning. Just one last inventory question. On the last call, you reduced inventory by about $70 million more than in Q3, but the margin impact was about 50 basis points less, is there -- is that what just simply because of the year-over-year comparison issue that you're speaking of or is that also because of which business lines you were reducing inventory in?

Nick Gangestad

No, Laurence, it's solely a function of the comp that we're going against in 2018.

Laurence Alexander

Okay, and then just to clarify the 200, 150 to 200 basis points, I think what that Nigel was referring to. I think some of the questions on the call I have framed it has a year, as a full-year impact. Is it a full-year impact or is it just a Q3 impact?

Nick Gangestad

That was just a Q3 comments on the impact it's having on our total margin.

Laurence Alexander

Okay, thank you.

Nick Gangestad

Yes.

Mike Roman

Thanks Laurence.

Operator

That concludes the question-and-answer portion of our conference call. I will now turn the call back over to Mike Roman for some closing comments.

Mike Roman

To wrap up, I am pleased with our team's progress in the third quarter, which demonstrates the strength of the 3M model and our ability to perform across the business cycle. Moving forward, we are focused on delivering greater value for our customers and shareholders building on the momentum from our execution and results in Q3, driving strong cash flow and improving growth. Thank you for joining us.

Operator

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