3M Co (MMM) CEO Discusses Q2 2013 Results - Earnings Call Transcript

Executives

Matt Ginter - Vice President, Investor Relations

Inge Thulin - Chairman, President and CEO

David Meline - Chief Financial Officer

Analysts

Deane Dray - Citi Research

Steven Winoker - Sanford Bernstein

Shannon O'Callaghan - Nomura

Stephen Tusa - J.P. Morgan

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3M Co (MMM) Q2 2013 Results Earnings Call July 25, 2013 9:00 AM ET

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the 3M Second Quarter Earnings Conference Call. During the presentation, all participants will be in a listen-only mode. Afterwards, we'll conduct a question-and-answer session. (Operator Instructions)

It is recommended that you use a landline phone if you're going to register for a question. As a reminder, this conference is being recorded, Thursday, July 25, 2013.

I'd now like to turn the call over to Matt Ginter, Vice President of Investor Relations at 3M.

Matt Ginter

Thank you and good morning. With me here today are Inge Thulin, 3M's Chairman of the Board, President and Chief Executive Officer; and David Meline, our Chief Financial Officer. Welcome to our second quarter business review.

Note that 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, I'd like to mention a few calendar items. We will announce our third quarter earnings on Thursday, October 24th and our fourth quarter earnings on Thursday, January 30th. In addition, we'll host an Investor Meeting on the afternoon of Tuesday, December 17th at the Grand Hyatt Hotel, in Midtown, Manhattan and for calendar purposes, please plan on 1 to 5 p.m. on that day.

If you turn to slide number two, please, 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.

So let's begin today's review and I'll turn the program over Inge. Please turn to slide number three.

Inge Thulin

Thank you, Matt, and good morning, everyone. I appreciate you joining us for today's call. Second quarter was another good one for 3M. We continue to grow our sales, profits and free cash flow in the face of a continued slow growth economy and a strong U.S. dollar.

Sales grew 3% year-on-year to $7.8 billion, an all-time record for any quarter in 3M's history. Organic local currency growth was 2.3% in the quarter with Health Care leading the way at 6%. Industrial and consumer each grew 3%, and safety and graphics grew 2%. In electronics and energy, sales declined 2% on an organic local currency basis.

As I told you in each of the last two quarters, we expected a challenging consumer electronics market in the first half of 2013, and our prediction was correct. We continue to anticipate some recovery in the second half of 2013 in this business.

Geographically, Latin America, Canada led way with organic growth of 9%, Asia-Pacific and Europe, Middle East, Africa each grew 2% and the United States was up 1%. Currency impacts reduced worldwide sales by 1.3%, impacted by the weak Japanese yen. Acquisitions added nearly 2 points to second quarter growth.

Second quarter operating margins was strong at 22% on a GAAP basis or 22.4% adjusted for recent acquisitions. Earnings was $1.71 per share up 3% versus second quarter of 2012. Free cash flow in the in the quarter was $1.3 billion a second quarter record for 3M and we converted 107% on net income to cash.

Finally, in the quarter, we returned $1.6 billion of cash to shareholders via dividends and repurchases, a step up versus recent quarters. David will have more to say on this in a moment.

Entering 2013, we anticipated slow market growth in the first half of the year and that is how it played out. I'm pleased with our performance especially given this backdrop. We also expected a second half recovery based on improving macroeconomic trends and recovery in the consumer electronics. This remains our view today.

Please turn to slide number four. Looking at full year guidance, we are maintaining our previous expected earnings range of $6.60 to $6.85 per share and organic local currency sales growth of 2% to 5%. We now expected currency impact will reduce sales for the year by 2% versus the prior expected reduction of 1.5%. Acquisition should add about 1.5% of sales per year.

As for the 2013 tax rate, we now anticipate the range of 29% to 29.5% versus a previous range of 29.5% to 30%. And we continue to expect free cash flow conversion of 90% to 100% for 2013.

Now I turn the call over to David for details on the quarter .

David Meline

Thank you, Inge. Let's begin with slide number 5, where I will break down the second trend in sales. We generated organic local currency growth of 2.3% on midst of continuing challenging economy. Volumes contributed 1.7% for a growth and selling prices increased 1.6%.

Acquisitions added 1.9 points to sales growth in the quarter, the majority of which came from Ceradyne which was acquired by our industrial business in last year's fourth quarter.

Foreign exchange impacts reduced sales by 1.3 percentage points in the second quarter, largely due to a 20% year-on-year decline in the Japanese Yen versus the U.S. dollar. In Dollar terms, worldwide sales grew 3% versus the second quarter of 2012. On a geographic basis, Latin America and Canada led the way again in this quarter with organic local currency growth of 8.5%.All five of our businesses posted positive growth in this region led by double digit results in Health Care.

Organic local currency growth Asia-Pacific was 2.2% in the second quarter, with Health Care again up double digits. Safety and graphics also had a nice growth in the quarter, China, Hong Kong, grew 3.4% organically in Q2 and Japan declined 2.3% year-on-year.

In EMEA or the combined Europe Middle East and Africa, second quarter sales increased 1.9% on an organic local currency basis. Four or five businesses posted positive growth lead by Health Care and industrial on a sub-EMEA level we achieved double digit organic growth in middle-east Africa and single digit growth in central East Europe. And organic growth turned positive in West Europe in the second quarter, which was encouraging to see after several down the quarters.

In United States, organic local currency growth was 0.8%, growth was positive on our Health Care, industrial and consumer businesses and declined in electronics and energy and in safety and graphics.

Let’s move to the income statement, please turn to slide number six. Second quarter sales were 7.8 billion up 3% in dollar terms. Our growth profit percentage was 48.3% down 30 basis points versus the second quarter of 2012. Investments in SG&A and R&D both increased 5% year-on-year, operating income was $1.7 billion down 1.5%.

Operating margins were 22%, down 90 basis points versus last year’s stronger Q2 results. Included in this quarter's results was a 40 basis points headwind from acquisition therefore underlying Q2 margins worth 22.4%. Profit leverage on organic volume growth added 20 basis points to second quarter operating margins and the combination of lower raw material costs and higher selling prices added 80 basis points.

In addition, lower year-on-year pension and OPEB expenses added 10 basis points to second quarter margins. Factory utilization reduced margins by 50 basis points, an improvement versus the first quarter and largely in line with our expectations. Strategic investments impacted margins by 40 basis points. This represents our ERP and business transformation effort along with more R&D aimed at disruptive innovation. Both will strengthen 3M for the future.

Finally, the combination of foreign exchange impacts, the recently enacted medical device tax in the U.S. and other factors reduced margins by 70 basis points year-on-year. Second quarter earnings were $1.71 per share, up 3% versus the second quarter of 2012. The second quarter tax rate improved to 27.4% versus 30.1% last year which added $0.06 to earnings and foreign exchange impacts reduced second quarter earnings by $0.02 per share.

Now let’s turn to cash flow, turn to slide number seven. Second quarter operating cash flow rose by $290 million year-on-year or 21% to $1.7 billion. The increase was due primarily to lower pension and OPEB contributions along with improved working capital. We invested $394 million in capital expenditures during the second quarter, up $36 million versus the second quarter of last year.

For the full year, we continue to expect capital expenditures in the range of $1.6 to $1.8 billion. Free cash flow rose by $254 million or 25% to $1.3 billion. Free cash flow conversion was 107% in Q2, a 19 point improvement versus the second quarter of 2012 and we continued to expect conversion of 90% to 100% for the full year.

Cash dividends paid were $436 million in the second quarter, up $26 million year-on-year. As a reminder, we increased the per share dividend by 8% this past February. This marks 55 consecutive years of dividend increases and the company has now paid a cash dividend for 96 consecutive years.

Gross share repurchases were $1.2 billion in the quarter, up $551 million compared to Q2 of 2012. And as Inge mentioned a step-up versus recent quarters, we now anticipate a range of $3.5 billion to $4.5 billion of gross repurchases for the full year 2013, versus a prior expectation of $2 billion to $3 billion.

We are increasing this range for a few reasons. One, our business is operating well and generating substantial free cash flow which we expect will continue. Two, rising interest rates are positively impacting our already well funded pension status. Three, we did not close any new acquisitions in the first half of 2013. And finally, our capital structure is already strong today and we do not intend to strengthen it further.

Let’s review in more depth our second quarter performance on a business-by-business basis starting with industrial. Please go to slide number eight. Second quarter sales were $2.7 billion in industrial, up 3.3% on an organic local currency basis.

Growth was strongest in the aerospace and automotive aftermarket businesses followed by liquid filtration, industrial adhesives and tapes and automotive OEM. Sales in industrial grew organically in all major geographic regions with Latin America and Canada up 9%, the U.S. and EMEA up 3%, and APAC up 2%. In November of 2012, we acquired Ceradyne, Inc one of the leading ceramics companies in the world. Ceradyne's sales were $116 million in the second quarter which added 4.6% to industrial growth and the business was profitable on a GAAP basis. We are pleased thus far with the integration effort and look forward to continued success in this business. Second quarter operating income was $599 million and reported margins were 22.5%. Exact positions industrial operating margins were 23.2%.

Now let's move to safety and graphics, turn to slide nine. Second quarter sales were $1.5 billion up 2% on an organic local currency basis. We generated a positive organic growth in commercial graphics, personal safety products, architectural markets and building and commercial services. Sales declined organically in the roofing granules business and in traffic safety and security systems. On a geographic basis organic local currency sales rose 9% in Latin America, Canada, 7% in Asia Pacific and 1% EMEA. The US declined 3% in the quarter. The FSTech acquisition added 1.1% growth in the quarter and the business is on track to meet its top and bottom line targets in 2013. We're aggressively integrating this business to capture significant cost and sales synergies. FSTech increases our relevance in the large highway infrastructure market and is the natural growth (inaudible) for a reflected sheeting and pavement marking business. Operating income in safety and graphics was $333 million and operating margins were showing 22.9% against the very tough comp of 25.9% in the prior year. Excluding acquisitions, second quarter of 2000 operating margins were 23.8% and we're investing to accelerate growth in this business particularly in personal safety in our recently formed mining, oil and gas business.

Next up is electronics and energy found on slide 10. In electronics and energy sales were $1.3 billion for the quarter down 2% in organic local currency terms. Operating income was $237 million and margins were 17.7%. As we anticipated margins were down year-on-year, but importantly showed nice improvement versus the 15.3% margin that we posted in the first quarter. Organic local currency sales declined slightly on the electronics side, consumer electronics and market demand has been fairly tepid throughout the first half of the year, but by and large the market seems to have stabilized and the third quarter sales should show recovery. End market inventories were heavy at year end and have improved as the first half has progressed with some modest [overwriting] still remaining in the hand held space.

And energy sales declined 4% in the second quarter. Our heartland electrical markets business had positive organic growth and continued to perform very well in Q2. This growth was more than offset by declines in other energy related businesses. Renewable energy in particular posted a double digit sales decline in the quarter, this market continues to seek a bottom which is impacting our growth. While we do see sales stabilizing in the second half and the comps begin to ease. We've been actively working to repurpose these assets for other 3M businesses where we anticipate growth. On a geographic basis organic local currency sales increased slightly in Latin America, Canada and declined in other regions.

Please go to slide 11. Health Care had another excellent quarter posting the highest organic growth and the highest operating margins amongst our five business segments. Sales totaled $1.3 billion up 6% on organic local currency basis. We continue to see broad based growth across much of the Health Care portfolio including health information systems, food safety, critical and chronic care, oral care and infection prevention. Sales in Health Care grew organically in all geographic regions, led by double-digit performances in both Latin America/Canada and Asia-Pacific.

Health Care second quarter organic sales growth was 15% in developing markets on top of 13% in the first quarter. These are highly promising growth sectors for 3M and we continue to funnel investment dollars towards them and we're encouraged to see the positive results. In developed markets Health Care grew 8% organically in Japan and 3% in both U.S. and Western Europe.

Operating income rose 1% to $417 million and margins were again strong at 31.2%. The recently enacted U.S. medical device tax was a 40 basis point drag on Q2 operating margins.

Finally, let's review the Consumer business found on slide number 12. Consumer also delivered a good second quarter, sales were $1.1 billion, up 3% on an organic local currency basis.

Profits rose 4% to $235 million and operating margins rose 40 basis points year-on-year to 21.4%. We grew organically across the Consumer portfolio most notably in Consumer Health Care where ACE and FUTURO brands showed particularly good growth in the second quarter.

We also posted positive organic local currency growth in our home care, stationery and office and do-it-yourself businesses. Q2 is when we begin to see the impact of a back-to-school season and growth thus far has been encouraging. We have good placement in promotional programs in place and we're seeing some sales lift from our newly introduced family of Scotch Expressions Tapes.

From a geographic perspective, organic sales growth was 7% in Latin America/Canada, 4% in Asia-Pacific and 2% in the U.S. Growth was slightly positive in EMEA.

In developing markets, the Consumer business grew 7% in organic local currency in Q2. Like Health Care, Consumer is one of our most significant growth opportunities in developing markets, as retail sectors expand along with the growing middle class. Developed markets grew 2% organically.

That wraps up the detailed outlook of the second quarter. Now, I will turn the call back over to Inge.

Inge Thulin

Thank you, David. Before we take your questions, I want to highlight our progress on several strategic fronts. Let's start first with a brief update on the integration of Ceradyne, which we acquired in November of 2012.

Sales and profit exceeded expectations for the quarter, very good results and strong evidence of our progress. You'll recall that earlier this year Ceradyne was awarded a $40 million plus order for protective armor plates. We saw some positive sales in fact from this win in the second quarter.

Let me also give some comments on our portfolio management efforts and our R&D investments. We are continuing to strengthen our portfolio through better product our decision and by addressing underperforming businesses.

For example, recently we announced a consolidation of our infrastructure protection division which or has been under strategic review into the electronic market division. We expect to gain rapid cost synergies as we increase the scale and efficiency on the newly combined entity. In addition, this division share common end markets such as construction, electrical utilities and electrical equipment manufacturing.

Back in May, we announced the sale of our fly fishing equipment business to Orvis. This is a good business and the market leader in its space, but it has no relevance to become important in the broader 3M portfolio.

We're also making good progress in identifying new and promising technology programs. As you may recall, we're planning to increase investments in longer term disruptive technologies, aimed at opportunities with significant growth potential. We formed a review team call the 3M Innovation Board, comprised by myself, David, our Chief Technology Officer and our Head of Corporate Strategy. The team meets quarterly to review milestone progresses and previously approved programs and to screen new investment ideas. I'm very encouraged of what I have seen so far.

Finally, we continue to move to move resources to our businesses with most promising growth opportunities. A great example is Health Care where the end markets continue to grow nicely and our technology and market positions gave us strong relevance with our customers.

Consumer is another example, where retail markets in developing economies are now beginning to develop. And we're actively prioritizing our (inaudible) to ensure that they have the resources they need to improve their already strong market positions.

In summary, first half conditions were challenging and 3M executed very well under the circumstances. We anticipate demand recovery in the second half of the year with some help from both the macro economy and the consumer electronics markets. And we remain focused on driving productivity and executing our plan with strong discipline.

Thank you for your attention. We will now take your questions and comments.

Question-and-Answer Session

Operator

(Operator Instructions) Our first question comes from the line of Deane Dray of Citi Research**.** Please proceed with your questions.

Deane Dray - Citi Research

Thank you. Good morning every one.

Inge Thulin

Good morning, Deane.

Deane Dray - Citi Research

I'd like to start off on geographies and maybe comment on the significance and we haven't seen this on a while, but central Europe are showing stronger growth than the U.S., it is just the easier comps, but maybe just give us a sense of what you are seeing in Europe now?

Inge Thulin

Good morning, Deane. You asked specific about central East Europe, where we have had a good base for quite some time as you know as we have built out our businesses then. We see continued good growth driven by specifically Russia, Turkey and Poland, but also a lot of that of smaller countries there are doing well.

So I think its broad based for us and I'm personally not surprised, I was (inaudible) visiting here, actually, this last quarter a couple of companies, including Russia. And it's very encouraging what we see in the marketplace then. Again, our portfolio have been build out with very much industrialist base, in that part of the world and now we see an increase in our businesses that's going into safety related businesses, but also health space taking off very well for us.

So I will say that, it's not a surprise for us. It's in fact encouraging as we have moved out our portfolio. And we have also made some investments that actually the last ten years or so relative to local capabilities both in terms of converting and manufacturing and now research and development. So we have a big place over there in Poland, in Rock Club, where we utilize a lot of capacity in order to serve that part of the world and recently as you maybe recall on the last quarter, we talked about, we're are now open also central excellence for logistics in Turkey, that overtime will service a breaching between central East Europe and middle East Africa.

So it's very encouraging for us and we would like to be bigger there and as you are talking about central East Europe and middle East Africa, also middle East Africa had very good growth for us in the quarter. That's from a lower base, but basically all countries there grew, except, we have a little bit slower growth in South Africa, due un-stability in that country, so overall very good.

Deane Dray - Citi Research

The commentary, same commentary for Western Europe?

Inge Thulin

Western Europe, first of all, we saw very, very slight growth for the first time in eight quarters which was encouraging for us. And the way we look upon it, we try to separate the in-between north and south, and in north are growing slightly better than in south. And I would say in terms of when you look upon the countries, I would say Germany was basically going sideways on a lower level. And we had little bit better growth in U.K. up to 5% to 6% in that country.

And north for us will be identified as Nordic U.K., Germany, Benelux and also Alpine as the Alpine countries. So they depend on Germany. So it's on a lower level, going sideways but at least was encouraging to see that for the first time in eight quarter, so slight, slight growth on that part of the world. And as we have talked about earlier, we have really worked on the back -- back end of the organization in order to streamline that combined regions and try to manage their cost in the backend of the operation.

Deane Dray - Citi Research

Thanks. And last one for me on safety and graphics, you have called out roofing granules and traffic safety and the slide also security but how would you split out the margin declined year-over-year across those three businesses?

Inge Thulin

I think there is three components there. You have, one-third is related to the FSTech acquisition. One-third is related to the decline in government-related project businesses and specifically into, say, road safety. And then finally, we are making some strategic investment in that business into mining oil and gas and to personal safety.

The personal safety is a Heartland division for us and heading the quarter 6% growth and we're continuing to invest there. So those are the three elements of that business. And if you take out FSTech that business had an operating income of almost 24% in the quarter, 23.8%. So very good in our view even if it was a decline versus last year but not any major concern.

Deane Dray - Citi Research

Great. Thank you.

Inge Thulin

Thank you.

Operator

Our next question comes from the line of Steven Winoker of Sanford Bernstein. Please proceed with your question.

Steven Winoker - Sanford Bernstein

Thanks and good morning all.

Inge Thulin

Good morning.

David Meline

Good morning.

Steven Winoker - Sanford Bernstein

I just want to follow-up Deane's questions geographically on the U.S. specifically was 2.3% last quarter, 0.8% this quarter, 0.7% volume. Just give us a sense for that slowdown specifically, if you could?

Inge Thulin

Yeah. I think when we look upon where we had solid growth, was in Health Care, industrial and consumer. So I think it was more relative base comparison and very much into some specific businesses that is, was related to government businesses as I talked earlier about and from safety and graphics business, very much related to road safety. And then we had also the granule business that I would say was an inventory correction for the whole industry that happened for that business specifically.

We had a relatively good consumer business and a good back to school selling which I think was -- yeah that segment was up almost 10% as we roll into the quarter. Now, we have to look upon the sell out as we know as go into the rest of the year.

Steven Winoker - Sanford Bernstein

Okay. And then, second question, when we look at pricing across the different geographies and you see Latin America 6.1% versus the volume of 2.4%. And I presume much of that as inflation driven. I mean, can you give us a sense for how much you think is inflation versus just other kind of pricing power. I mean, obviously you are exhibiting a lot of pricing power there. It would be helpful to understand this?

David Meline

Yeah. Interesting therefore I can comment. So if you look at and correctly a significant part of our reported price in the quarter was driven by Latin America, which is -- it was already up in the first quarter and we saw a little bit higher this quarter. And that's largely being driven by the fact that we have some of the currencies in several countries as well as inflation has been picking up, so what you see is the businesses are reacting to that to make sure we're preserving our profitability and it's in an environment where we're able to -- with the good brand positioning we have we're able to put through those prices and still deliver growth in the region.

Steven Winoker - Sanford Bernstein

Okay and sorry just one more. The 40 basis point to strategic investment margin headwind, I mean how long should we -- should we speak about building that into our forecast?

David Meline

Yeah, I would say that the strategic investments for doing those as I mentioned earlier specifically related to our ERP business transformation which will go on for several years. Now, on year-over-year basis we expect that the phenomena you see this year will continue certainly through the end of this year and in the case of the innovation spend we're starting to see that picking up somewhat as we get into these approved programs. So I think from a planning perspective at least through this year you should expect that kind of investment level on a year-over-year basis and then as we get into next year's planning we'll give you guys an update as to what to think about that.

Steven Winoker - Sanford Bernstein

Okay, thank you.

Operator

Our next question comes from the line of Shannon O'Callaghan of Nomura. Please proceed with your question.

Shannon O'Callaghan - Nomura

Good morning, everyone.

Shannon O'Callaghan - Nomura

Hey, David maybe -- can you just engage sort of an update on EPS contribution to now going forward from shares, tax, pension because you've been buying back more shares, you've got lower share calendar now that still goes lower and I imagine your pensions move ahead with interest rates. So maybe just engage what we should expect in terms of EPS (inaudible) from those?

David Meline

Yeah, so if you look at pensions what you would observed as we've called out few of the impact on margin in the first half. If you look at first quarter, second quarter that's added about point -- 3 points to the margins in the first half and you should expect that to continue through the balance of the year. Obviously as you start then looking forward into the future if we stay in this kind of an interest rate environment you'll start to see our expense further decline as we talked about last November. If you look at share counts correctly we've up the amount that we would intend to buyback this year and so I think you can calculate the figures. But we will see some reduction in share count impacting the second half, but as do the averaging level the increase that we see in the actual buyback in the second half will have a bigger impact next year than this. So we'll see some pickup in the second half.

Inge Thulin

One thing that I would add to that Shannon is foreign exchange was a headwind in the first half to the tune of about $0.3 a share and that will get a little bit separate in the second of the year, when it would be closer to about a nickel in the second half.

Shannon O'Callaghan - Nomura

And how should we interpret the share repurchase in terms of what drove your decision to increase it and this is reset to a higher range or is this just a one off?

David Meline

Yeah, it's a good question. So as I tried to call out for your -- in deciding how to proceed on that, we first and foremost look at how the business is running and certainly we're pleased with the performance of the business now and we think that we'll continue in the context of both the health of our business and the economy. Secondly the pension plans, we've been -- obviously with the tick up in interest rates, if you look at our funding position -- funded position, at midyear we were about 94% funded globally in all of our plans versus 87% in year end. So (inaudible) that to continue that will be some easing on the demand for capital in that area which factors into our decision making and then as I also mentioned acquisitions we did not deploy in the first half. We continue to expect to and would guide to a billion to two this year, but inevitably timing is very difficult to call and certainly in this lower interest grade environment we're seeing that finding transactions where we can create value for 3M has been more difficult for us recently. So that will factor into our thinking on sources and uses of cash.

And then finally, as I mentioned, the capital structure of the company, we think is certainly very strong and is adequate, and we wouldn't foresee strengthening it further. So add those pieces up, look at how those evolve that will inform us as to what kind of planning will do in terms of our buyback activity going forward.

Shannon O'Callaghan - Nomura

Just to clarify on the tax and pension, do you still, tax is coming in lower this year, do you still expect it to go lower in '14 and do you have a read on what pension payment would be at this point in '14?

David Meline

Yeah. Sure. So that's right. So we guided tax to 29% and 29.5%, which is more in line with the tax rates that we had last year. Everything we see and again we are just now in the update of our long-term plan, we just started that. But we would foresee, we had indicated last year that by the end of the year period we would expect our rate to be in the neighborhood of 27% and I don't have any reason right now to things that would change as to the year-by-year precise amounts that something we will have to refine here as we go through the balance of the year.

And in terms of pensions, yeah, I mean, as you know, it's a very significant consideration for 3M. We have very significant obligations and we've absorbed over the last five years an increase in our annual pension expense cumulatively of $550 million.

This year our pension expense versus last year has declined by $100 million and given the very strong funded position we have which is improving, given the fact that we've now transitioned our workforce globally such that we are moving increasingly into defined contribution type profiles, considering very good return on assets, we've been generating over recent years. And then finally, rising interest rates would cause us to expect expenses to decline. So if you were to close the year today, what we would think is that we'd have $100 million or more decline in an expense next year.

Shannon O'Callaghan - Nomura

Great. Thanks a lot guys.

Inge Thulin

Yeah.

Operator

Our next question comes from the line of Stephen Tusa of J.P. Morgan. Please proceed with your question.

Stephen Tusa - J.P. Morgan

Hey. Good morning.

Inge Thulin

Good morning.

David Meline

Good morning, Steve.

Stephen Tusa - J.P. Morgan

Can you maybe just talk about any update to the price cost forecast for the year, it's kind of in line with the first quarter, there is some obviously some inflation driven price your are getting in Latin America pricing was better. So just maybe talk about that for the second half?

David Meline

Sure. In terms of the price cost, we'd indicated that, we expected some price improvement initially which were then decline as we walk through the year, and that continues to be our view on an overall basis. So we have some price performance in the first half here which was primarily driven by increases we took during the year last year, so naturally that would be declining as we move into the second half.

In terms of the other piece of price which is, is inflation in foreign exchange driven that we'll have to see how things develop. But I would say that you could expect that we would continue to have a positive contribution there which would then be enabling us to offset the negative impacts of exchange.

Stephen Tusa - J.P. Morgan

Okay. So the price cost spread which I think you said we are going to be kind of plus or minus this year for the year is now better than, it's now more favorable…

David Meline

Yeah. I mean.

Stephen Tusa - J.P. Morgan

… (inaudible) so far.

David Meline

Yeah. Sure. Price cost we expect will continue to decline quarter-by-quarter but it would be more favorable then what we had initially indicated at beginning of the year.

Stephen Tusa - J.P. Morgan

Got you. And now you in-- are you in position to put through, this year with raw materials in the economy, are you in position to get more price this year like you have in previous years, like another unusual kind of step up like you had maybe year ago or is it more normal this year.

Inge Thulin

Right. Yeah. From a planning perspective we don't, other than specific situations where you got exchange or inflation driven price movements, we don't right now have particular plans to be driving price. Certainly, to the extent which is normally what we drive to where we have significant and fresh products and good brand positioning, we have these (inaudible) but in the current cost environment our thinking is, is that steady as you go is the right poster for the company.

Stephen Tusa - J.P. Morgan

Got you. One last quick one, I think can you maybe comment on what you are seeing in Latin America, lot of cross occurrence in the economy there, maybe if you could just talk about how you see the second half playing out?

Inge Thulin

Well, we are optimistic relative to the second half and has David has comments, relative to the relation of organic growth and price for the first and second quarter, we are on plan relative to execution, we see a slight uptick coming in Brazil first, which is good, it's the biggest subsidiary for us down there.

And as you know what we have talked about before, we have a very broad based both portfolio and probably did best balance portfolio in only part of the world, in Latin America. And we have execution capabilities across world countries. So we see it a very positive for the rest of the year as well. And as I said, as we are being in that part of the world since 1946 and it's the -- I would say the role model relative to us, how to build out businesses in developing economies and I've done very well, we feel good not only for the rest of this year, but for many years to come.

And as you know, that business for us is as sizable as China and it's growing faster and it's very, very profitable. So we are optimistic about Latin America as we go ahead as we go ahead. In fact, I think, there are some acceleration for us for the rest of the year and beyond.

Stephen Tusa - J.P. Morgan

Okay. Great, thanks.

Inge Thulin

Thank you.

Operator

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

Andrew Obin - Bank of America Merrill Lynch

Hi, guys, good morning.

Inge Thulin

Good morning, Andrew.

David Meline

Good morning.

Andrew Obin - Bank of America Merrill Lynch

Yes. Just a question on your Share buyback. Can you just tell us on net basis, should you increase the buyback, versus the previous expectations, right, because the stock has gone well, I'm just wondering where did options go?

David Meline

Right. So if you look at the reissuances that we expect to occur during the year, I think, we had originally guided, $1 billion to $1.5 billion. And right now, it looks to us like it will be at or slightly above the high end of that range. So think about a billion and half, maybe slightly above that, depending on what happens from the balance of the year. So if you then think about net, the 3.5 to 4.5 would imply somewhere approaching $2 billion to $3 billion net versus the original guidance of $1 to $1.5 billion.

Andrew Obin - Bank of America Merrill Lynch

Thank you very much. And second question on electronics and energy. If you look at sequential improvement, how sustainable it is going to the second half and what leverage do you still have left to first sort of to get this business improving in the absence of a recovery in electronic side.

David Meline

First of all, it's as you comment yourself, it's stabilized relative to first quarter. So we had -2 and -2, so basically you can say stabilized in terms of the growth on a lower level for us. You can see that we improved margins and that's the result went from 15.3 to 17.7 sequentially. And that's based on mixed improvement and better utilization. And you can also see the picking action here relative to our portfolio management, we have recently announced some combination of the couple of divisions where we then would drive cost and synergy in the backdrop is well, still capitalized on the front end.

Now it's clear as we have said earlier that, we're counting on the pickup in consumer electronic in the second part of the year and we see small evidence of that as we move into Q3 here. And we based out of course on what we see our (inaudible) on platforms. So I will say that we are on plan relative to that business, we need to see a big pickup in consumer electronics. But the way we look at on that, we see what we're expecting, we see that that's coming in our order flow for Q3. And then what will drive that for the rest of the year is of course, end market demand, right, which is where we are sitting still a little bit of difficult for us to see but we -- that's how we are planning for now.

Andrew Obin - Bank of America Merrill Lynch

Okay. Can you continue to improve margin on the electronic side in the absence of growth?

David Meline

Yeah. We can.

Andrew Obin - Bank of America Merrill Lynch

Thank you.

Operator

Our next question comes from the line of Scott Davis of Barclays. Please proceed with your question.

Scott Davis - Barclays

Thanks, guys. Good morning.

Inge Thulin

Good morning.

David Meline

Good morning.

Scott Davis - Barclays

I know it maybe hard to answer this specifically, but when you think about, Inge, the investments that you've made in R&D and also just in the core businesses and the changes you have made in, at what point do you see that inflection, do you think where you start to outgrow global GDP, even the last couple of years you have been growing pretty much in line with pretty sluggish global GDP. But I would imagine there has to be a point where you start to show some -- some real progress. Can you give us a sense of -- I just said 2014, can you -- can we see it this year, is it more like 2015, just give us a bit of sense of what you think?

Inge Thulin

Well, first of all I would say that we have outperformed the IPI lately. Right, so you look upon last quarter, you see this quarter, we have outperformed IPI just to make that clear because I think you said that we had not, right, in line, I think we outperformed. So we are pleased with that and just to give in perspective, at least while I am sitting, I am pleased that we have shown three quarters in a row organic local currency growth, right.

So we had Q4 last year, Q1 and now Q2. So that's first the baseline that's what I'm looking upon. So that's very encouraging. Now, when you make those shifts as we are doing, right, there is a couple of strategic shift in the company. Portfolio management is a level for us and is an important one. And as I talked about earlier we are -- we have put that in place. We are very serious about it. We are on that the whole time. That's an important level.

And the second one is our investment in research and development, which is very much at this point in time, relative to disruptive technologies that will have a longer term outcome. However, in that pipeline, there is some project that I believe that we will be able to commercialize in the middle of next year.

So I think the way the piece is moving for us, it is difficult to say exactly a time but you know I think that we should -- 12 to 18 months from now, we should start to see the traction of the moves that we are doing. And those elements here that are very important that all in order for us to strengthen the company as we go ahead. And I think as I said and David talked to earlier about our ERP initiative, as you think about the level for us is portfolio management, it is research and development, and then it is investment in ERP.

Those three put together will strengthen the company as we move forward. But you know we start to see -- I start to see good progress on the growth side, but I am still not happy. Let me say it I am still not happy but I can see that we start to take market share and we are doing very well specifically in the Heartland division start to really get some good traction and automotive aftermarket this quarter was very good. And that again is related to us to be able to take market share and penetrate better on the world.

The same I talked about personal safety, we had 6% growth in a big very profitable division for us that has the brand equity and the position around the world. So, I think that you see the focus we have got around the Heartland divisions has helped us in order to grow and is based on both taking market share and to improve penetration.

And then at we look upon the businesses that have underperformed, that will over time help us to accelerate growth in those, what we call push forward at our businesses that are very good, very strong for us using multiple technologies but have a relatively smaller size based on their market but those markets are growing faster. So, I don't know if it is helping you, but at least…

Scott Davis - Barclays

I understand.

David Meline

It's not the direction where we're going.

Scott Davis - Barclays

Yeah, now I think the answer is actually very comprehensive in what you said about to be level in M&A is very relevant too. So as a follow up, you talked about M&A just because it is so important for a company that generates as much cash as you do to either have an outside buyback program or an outside M&A program. But what is your buy as is it relates to the type of things you want to buy? In your tenure we've seen -- obviously if you buy Ceradyne, the (inaudible) fell through, these are fairly low growth assets, I mean is this -- are there emerging technologies that you're -- that you're looking at or is it more matured companies, I mean, just give us a sense of what we could expect out of M&A and the type of assets going forward?

David Meline

I think I'll go back and repeat what I've said earlier relative to -- you should expect slightly bigger than you've seen in the past for the last five to six years. We did a, 60 to 70 acquisitions the last six years or so, many of them were very small and in geographical areas that was way out and was maybe in some cases difficult for us to lever from a execution perspective on the global base. So I think you should see acquisitions that are slightly bigger than in the past and you should see acquisitions that we should be able to lever and scale on a global base ideally and for sure on the regional base. And if there is a technology as part of it that will be very, very interesting.

And I think that was exactly what Ceradyne gave us. Ceradyne had a good solid front end in terms of business, but in addition there was a technology played at the very important for us that we can lever over many divisions in the company. So I think that's what you should think about. And that's also why the portfolio work that we're doing is so important, but across business as we go also be able for us to categorize the businesses and look upon opportunities as you go ahead. So we have a very active pipeline and as you know that we're looking upon them from different perspective and -- but I think you should think about it in the way of slightly big than the past, should be -- faster growing on average for the company will be ideally and then a technology piece of it will really be good because that's what we're all about, so we can leveraged around many, many divisions in the company due to the fantastic vertical integrated model we have both in research and development and manufacturing and the subsidiary strength.

Operator

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

Joseph Ritchie - Goldman Sachs

So as it relates to organic growth, you did maintain your organic growth guidance for the year, yet outside of industrial and facing graphics counts do get harder across your segments in the second half. And in the midpoint, your guidance essentially implies an acceleration beyond the easing count. So my first question is were there any changes to the segment level growth expectations based on what you reported today and maybe you can talk a little bit about your confidence on hitting that second half organic growth guidance?

David Meline

Sure, so if you looked at the guidance that we've offered, which is maintaining the two to five for the year, which is what we've had in place whole year. We had expected and that continues to be our view that we would see a second half that improves from the first, so no difference there. If you then look at the sector level, we gave guidance on the sectors at the beginning of the year for the whole year and generally we expect to be operating within those levels and those ranges. If there's any area where we have a -- the biggest question that specifically has been in years on electronics and energy, so if you think of our range for the year operating to the low end of that range would be in an environment where we wouldn't see any pick up in the economy, we wouldn't see any pick up in the electronics and energy space, which is not the environment that we're presently expecting. To operate towards the high end of that range for the year it would, as Inge was talking about, it would require not only the improvements that we're foreseeing in the third quarter in the electronics, consumer electronics space, but it would also foresee some additional economic pickup generally which is certainly not out of line with economic forecasts that are out there.

And secondly, it would require pretty robust end-market demand in areas like general consumer, so think about a good sale out for the holiday season and then specifically in the consumer electronics business.

Joseph Ritchie - Goldman Sachs

Okay, great. That's really helpful color David. And maybe one question for Inge on Ceradyne specifically. It seems like things went well in the second quarter, still behind plan for the first half of the year on the sales side, but doing better on EBITDA.

My question is really around the technology platform and the uses of that platform across your other divisions. Can you talk a little bit about the opportunity there and whether you're starting to deploy it across to some of the other 3M divisions.

Inge Thulin

Yeah. We do and I think it's very much aligned relative to the synergies we see with different division. I think at this point in time 13 -- I think its 13 or 15 division that see that they can utilize the technologies that came in from Ceradyne. So we purchased the company and move it into one division and industrial. I think beyond that now there is a team in place that's looking upon the opportunities across businesses.

And I think it's from the business groups where basically three of the five are very much involved. And I think its 13, let say, its 13 division I think it maybe 13 to 15 that see the opportunities in their different spaces. So it's we're very, very encouraged actually what we see then and Fred Palensky, our CTO, is very encouraged what we've seen and he was very pleased even before we did acquisition.

So I think we'll be able to talk about it more later when we see some specific programs coming out of the pipeline, but we're very pleased. And as I said, that acquisition maybe different in the way that was not only for us to purchase a position in the marketplace but also to get build out the technology platform that we had already in ceramics make it broader and deeper and then be able to kept for life which is what 3M is very good at.

Joseph Ritchie - Goldman Sachs

Okay. Thank you very much.

Inge Thulin

Thank you.

Operator

Our next question comes from the line of Ajay Kejriwal of FBR. Please proceed with your question.

Ajay Kejriwal - FBR Capital Markets

Thank you. Good morning.

Inge Thulin

Good morning.

David Meline

Good morning.

Ajay Kejriwal - FBR Capital Markets

Maybe just on Health Care service, it's very nice to see your highest margin business also your fastest growing and we've seen that for the last couple quarters now. So maybe talk about what you're seeing there, what's driving that growth? I know you're seeing very high growth rates in the developing market. So talk a little bit about sustainability, especially given what we're seeing on the macro side on the developing country. So one, what's your outlook is and then also implications for margins.

Inge Thulin

Yeah. First of all, when you think about that portfolio, 78% of that portfolio is today in developed economies. So you have 22% in the developing, if you look upon that portfolio from our perspective in Health Care. So that's indicating that we've a very strong position in the developed world based on the value proposition coming out from those businesses through our base.

So that's a very strong position to be in and we are growing in the developed world as well. We've 3% growth in the developed world. So think about that. That's just indicating that the value proposition that we're providing to our customers are very strong.

In the developing world, the growth was 15% in the quarter. And as we've talked about earlier, we build out our businesses in the developing world, there is now the opportunity also for developed solutions in that part of the world.

And I think, hopefully, you remember the way that we described how we build out the business staring with infrastructure, manufacturing, safety, retail and the finally Health Care.

In many countries, we are now coming to that point in the end relative to Health Care and in fact, Health Care is going ahead of retail in many ways relative to the execution of our plan because there is a different type of network from key opinion leaders for Health Care versus in consumer, which is brand equity that is a key element here to be successful. So that -- I think, that's the reason for us that we have growth. We have growth both in developed and developing world, the value proposition is strong in both places. We have made investments for many years into the developing world in order to be ready for execution as that the programs are coming.

And we are able to show here that it's sustainable relative to margins and maybe (inaudible) said earlier, we should run that business overtime in the high 20s, but we'll be running it above 30 and we're still running it above 30. So that's despite that we are building out of capabilities very much relative to the execution of the programs, which means coverage in the marketplace.

And we are very efficient manufacturing a model there as well, where we're able to utilize both two huge centers around the world for manufacturing, but also many smaller converting facilities. So it's a very good business for us. We're doing very well and we are very pleased. And this is not -- it's not by accident helping planned for long time for the team here in order to come up to this position.

Ajay Kejriwal - FBR Capital Markets

Of course, it's a very nice business and it tells that it's also your highest margin business, so good work there, maybe one question for David on utilization. So it's still a headwind, how should we think about that for the rest of the year, does that headwind come down as you allocate those assets to other businesses or is that more related to volume coming back in electronics.

David Meline

Yeah, so Ajay, I would say generally the trend we are working towards obviously is the fully utilized all of our assets. So we're driving to get better utilization and obviously as we always are. We see some good progress here. So as I talked about last quarter, a couple of sources of that underutilization related to some businesses and renewable energy and one of our automotive areas where we had some inventory overhang, so that largely been addressed.

What's true for us is, is that the renewable space will continue to be an area that we're working through to identify exactly what are the prospects for the business going forward, how do we best participate there to offer technology solutions and also generate a return to the company. And that's probably going to take us into 2014 to come to some final solution.

So we will have some issues that we'll continue to deal with for the foreseeable future, but I think as you've already seen, we're starting to get our arms around it and certainly the trend should continue to be down.

Ajay Kejriwal - FBR Capital Markets

Thank you.

Operator

Our next question comes from the line of Laurence Alexander of Jefferies. Please proceed with your question.

Laurence Alexander - Jefferies

This is very quick one. As I know we've gone over. As you look at the ramp in your R&D investments in these new areas you are looking at investing in, is there an implication that in a few year result, there could be a step up in the CapEx cycle for the company for some reason or is it all going to be roughly the same capital intensity as the business with the business as you are already in?

David Meline

Sure. Yeah. I would say Laurence, in terms of our outlook for capital, as you would know, where we do the play capital at a level which is typically higher than the average peer, which is an outgrowth of the very significant level of vertical integration that the company has, because a lot of our technology is proprietary and know how that we want to preserve and therefore to do that when it's in the manufacturing process area, we feel the best strategy is to do it ourselves.

So we're quite vertically integrated and that will continue. In terms of does the step up in investment in R&D imply an increase in our CapEx? Right now we don't foresee that to be the case, but quite honestly we have to monitor how that progresses, because we -- there is a bunch of thing we're working on that we haven't fully developed yet. But I would say if I look over a longer period of time, I wouldn't expect that there is some implied step-up in our CapEx.

Laurence Alexander - Jefferies

Thank you.

Inge Thulin

Yeah.

Operator

And our last question comes from the line of Nigel Coe of Morgan Stanley. Please proceed with your question.

Nigel Coe - Morgan Stanley

Yeah. Thanks. Good morning and thanks for squeezing me in here. Again a couple of quick ones from me, just return to the margin which -- this is probably for David. The impact of FX, just one concern that's the transactional impact of U.S. export?

David Meline

That is a -- yeah, it is.

Nigel Coe - Morgan Stanley

Okay. Great. And then, maybe just a quick updates on where we are on $2.5 billion of, I guess, restructuring portfolio. You've made a couple of actions in terms of one business in the [E&E] and the 3D business back in earlier this year. Just wondering where we are in terms of progress on that $3.5 million?

David Meline

We have made some progress. And as I said, we have not put a timeline on it as that's difficult to do when you do business as you know in terms of what needs to be done. But we are focusing in on them and you have seen now probably three actions that have been taken relative to make sure that we improved in precision. We sold off one business and we have combined two and in fact, we're harvesting fourth one.

So that's an ongoing process and we take it very seriously. So there is not a timeline on it by definition but what I have said to you and I have said internally, you cannot stay in that category for long. And so we are working on it and we are also doing the right thing in order for us to evaluate the right precision for those businesses as we move ahead.

Nigel Coe - Morgan Stanley

And could you talk little about billion dollars of action is taken in those four businesses so far?

Inge Thulin

In terms of the portion of the businesses and the revenue impact?

Nigel Coe - Morgan Stanley

Yeah.

Inge Thulin

That's in the ballpark.

Nigel Coe - Morgan Stanley

Yeah. Great. Thanks guys.

Inge Thulin

Thank you.

Operator

That concludes the question-and-answer portion of our conference call. I will now turn the call back over to 3M for some closing comments.

Matt Ginter

This is Matt. I'll just say thanks to everybody for joining us for your questions. I appreciate your continued interest in 3M and Bruce and I'll be around for any follow-ups. 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 line.