

ILLINOIS TOOL WORKS INC
Form 10-Q
August 07, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 1-4797

ILLINOIS TOOL WORKS INC.
(Exact name of registrant as specified in its charter)

Delaware 36-1258310
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification Number)
organization)

155 Harlem Avenue, Glenview, IL 60025
(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code) 847-724-7500

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

The number of shares of registrant’s common stock, \$0.01 par value, outstanding at June 30, 2015: 366,088,569.

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Part I – Financial Information

Item 1 – Financial Statements

Illinois Tool Works Inc. and Subsidiaries
Statement of Income (Unaudited)

In millions except per share amounts	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Operating Revenue	\$3,434	\$3,719	\$6,776	\$7,288
Cost of revenue	2,024	2,219	3,994	4,377
Selling, administrative, and research and development expenses	622	677	1,238	1,359
Amortization of intangible assets	58	60	117	122
Operating Income	730	763	1,427	1,430
Interest expense	(55	) (64	) (109	) (128
Other income (expense)	21	7	42	16
Income from Continuing Operations Before Income Taxes	696	706	1,360	1,318
Income Taxes	216	212	422	396
Income from Continuing Operations	480	494	938	922
Income from Discontinued Operations	—	998	—	1,043
Net Income	\$480	\$1,492	\$938	\$1,965
Income Per Share from Continuing Operations:				
Basic	\$1.31	\$1.22	\$2.53	\$2.23
Diluted	\$1.30	\$1.21	\$2.51	\$2.22
Income Per Share from Discontinued Operations:				
Basic	\$—	\$2.47	\$—	\$2.52
Diluted	\$—	\$2.45	\$—	\$2.50
Net Income Per Share:				
Basic	\$1.31	\$3.69	\$2.53	\$4.76
Diluted	\$1.30	\$3.66	\$2.51	\$4.72
Cash Dividends Per Share:				
Paid	\$0.485	\$0.42	\$0.97	\$0.84
Declared	\$0.485	\$0.42	\$0.97	\$0.84
Shares of Common Stock Outstanding During the Period:				
Average	366.2	404.7	371.4	413.3
Average assuming dilution	368.4	407.6	373.8	416.3

The Notes to Financial Statements are an integral part of these statements.

Illinois Tool Works Inc. and Subsidiaries
Statement of Comprehensive Income (Unaudited)

In millions	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net Income	\$480	\$1,492	\$938	\$1,965
Other Comprehensive Income (Loss):				
Foreign currency translation adjustments, net of tax	169	(50	) (408	) (22
Pension and other postretirement benefit adjustments, net of tax	11	(11	) 20	(3
Comprehensive Income	\$660	\$1,431	\$550	\$1,940

The Notes to Financial Statements are an integral part of these statements.

Illinois Tool Works Inc. and Subsidiaries
Statement of Financial Position (Unaudited)

In millions	June 30, 2015	December 31, 2014
Assets		
Current Assets:		
Cash and equivalents	\$2,858	\$3,990
Trade receivables	2,412	2,293
Inventories	1,191	1,180
Deferred income taxes	185	212
Prepaid expenses and other current assets	387	401
Total current assets	7,033	8,076
Net plant and equipment	1,636	1,686
Goodwill	4,543	4,667
Intangible assets	1,679	1,799
Deferred income taxes	298	301
Other assets	1,159	1,149
	\$16,348	\$17,678
Liabilities and Stockholders' Equity		
Current Liabilities:		
Short-term debt	\$819	\$1,476
Accounts payable	533	512
Accrued expenses	1,147	1,287
Cash dividends payable	178	186
Income taxes payable	61	64
Deferred income taxes	8	8
Total current liabilities	2,746	3,533
Noncurrent Liabilities:		
Long-term debt	6,994	5,981
Deferred income taxes	363	338
Other liabilities	939	1,002
Total noncurrent liabilities	8,296	7,321
Stockholders' Equity:		
Common stock	6	6
Additional paid-in-capital	1,113	1,096
Income reinvested in the business	17,755	17,173
Common stock held in treasury	(12,526)	(10,798)
Accumulated other comprehensive income	(1,046)	(658)
Noncontrolling interest	4	5
Total stockholders' equity	5,306	6,824
	\$16,348	\$17,678

The Notes to Financial Statements are an integral part of these statements.

Illinois Tool Works Inc. and Subsidiaries
Statement of Cash Flows (Unaudited)

In millions	Six Months Ended	
	June 30,	
	2015	2014
Cash Provided by (Used for) Operating Activities:		
Net income	\$938	\$1,965
Adjustments to reconcile net income to cash provided by (used for) operating activities:		
Depreciation	119	137
Amortization and impairment of goodwill and other intangible assets	117	122
Change in deferred income taxes	(7	) 51
Provision for uncollectible accounts	4	5
(Income) loss from investments	3	(6
(Gain) loss on sale of plant and equipment	(1) —
(Gain) loss on discontinued operations	—	(1,709
(Gain) loss on sale of operations and affiliates	(16	) 5
Stock-based compensation expense	24	21
Other non-cash items, net	5	4
Change in assets and liabilities, net of acquisitions and divestitures:		
(Increase) decrease in-		
Trade receivables	(189	) (232
Inventories	(48	) (55
Prepaid expenses and other assets	26	(71
Increase (decrease) in-		
Accounts payable	40	(22
Accrued expenses and other liabilities	(116	) (1
Income taxes	(9	) 746
Other, net	—	(73
Net cash provided by (used for) operating activities	890	887
Cash Provided by (Used for) Investing Activities:		
Acquisition of businesses (excluding cash and equivalents) and additional interest in affiliates	(6	) (6
Additions to plant and equipment	(147	) (146
Proceeds from investments	3	11
Proceeds from sale of plant and equipment	12	15
Net proceeds from sales of discontinued operations	—	3,177
Proceeds from sales of operations and affiliates	29	9
Other, net	(52	) 14
Net cash provided by (used for) investing activities	(161	) 3,074
Cash Provided by (Used for) Financing Activities:		
Cash dividends paid	(365	) (355
Issuance of common stock	47	81
Repurchases of common stock	(1,786	) (2,905
Net proceeds from (repayments of) debt with original maturities of three months or less	(656	) (1,680
Proceeds from debt with original maturities of more than three months	1,098	3,329
Repayments of debt with original maturities of more than three months	—	(801

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Excess tax benefits from stock-based compensation	16	19	
Other, net	(13) (12)
Net cash provided by (used for) financing activities	(1,659) (2,324)
Effect of Exchange Rate Changes on Cash and Equivalents	(202	) 42	
Cash and Equivalents:			
Increase (decrease) during the period	(1,132	) 1,679	
Beginning of period	3,990	3,618	
End of period	\$2,858	\$5,297	
Supplementary Cash and Non-Cash Information:			
Cash Paid During the Period for Interest	\$113	\$93	
Cash Paid During the Period for Income Taxes, Net of Refunds	\$390	\$343	
The Notes to Financial Statements are an integral part of these statements.			

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Illinois Tool Works Inc. and Subsidiaries
Notes to Financial Statements (Unaudited)

(1) Financial Statements

The unaudited financial statements included herein have been prepared by Illinois Tool Works Inc. and Subsidiaries (the “Company”). In the opinion of management, the interim financial statements reflect all adjustments of a normal recurring nature necessary for a fair statement of the results for interim periods. It is suggested that these financial statements be read in conjunction with the financial statements and notes to financial statements included in the Company’s 2014 Annual Report on Form 10-K. Certain reclassifications of prior year data have been made to conform with current year reporting.

(2) Discontinued Operations

The Company periodically reviews its operations for businesses that may no longer be aligned with its enterprise initiatives and long-term objectives. As a result, the Company may commit to a plan to exit or dispose of certain businesses and present them as discontinued operations. The following summarizes the Company’s discontinued operations.

Third Quarter 2013 Discontinued Operations - In the third quarter of 2013, the Company committed to a plan to sell the Industrial Packaging business and began classifying this business as held for sale. The Industrial Packaging business was sold in the second quarter of 2014.

In the third quarter of 2013, the Company also committed to a plan for the divestiture of a construction business previously included in the Construction Products segment. This business was classified as held for sale beginning in the third quarter of 2013 and was sold in the second quarter of 2014.

First Quarter 2013 Discontinued Operations - In the first quarter of 2013, the Company committed to a plan for the divestiture of a construction distribution business previously included in the Construction Products segment. This business was classified as held for sale beginning in the first quarter of 2013 and was sold in the second quarter of 2014.

As of the second quarter of 2014, the Company had completed the divestiture of all of the businesses previously reported as discontinued operations.

Results of the discontinued operations for the three and six months ended June 30, 2014 were as follows:

In millions	Three Months Ended June 30, 2014	Six Months Ended June 30, 2014
Operating revenue	\$212	\$798
Income before income taxes	\$1,724	\$1,796
Income tax expense	(726	) (753
Income from discontinued operations	\$998	\$1,043

Income before income taxes from discontinued operations was income of \$1.8 billion for the six months ended June 30, 2014. The income in the first six months of 2014 included the pre-tax gain of \$1.7 billion (\$1.1 billion after tax) on the sale of the Industrial Packaging business recorded in the second quarter of 2014. Income tax expense in the first

six months of 2014 included \$175 million of U.S. income tax expense related to the repatriation of approximately \$1.3 billion of international proceeds from the sale of the Industrial Packaging business.

In April 2014, the Financial Accounting Standards Board ("FASB") issued authoritative guidance to change the criteria for reporting discontinued operations. Under the new guidance, only disposals representing a strategic shift in a company's operations and financial results should be reported as discontinued operations, with expanded disclosures. In addition, disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify as a discontinued operation is required. The Company adopted this new guidance effective January 1, 2015. The new guidance applies prospectively to new disposals and new classifications of disposal groups held for sale after such date. As a result, this guidance did not have any impact on the Company's financial statements or related disclosures upon adoption.

(3) Income Taxes

The Company files tax returns in the U.S. and various state, local and foreign jurisdictions. These tax returns are routinely audited by the tax authorities in these jurisdictions including the Internal Revenue Service ("IRS"), Her Majesty's Revenue and Customs, German Fiscal Authority, French Fiscal Authority, and Australian Tax Office, and a number of these audits are currently ongoing, which may increase the amount of the unrecognized tax benefits in future periods. The Company believes it is reasonably possible that within the next twelve months the amount of the Company's unrecognized tax benefits may be decreased by approximately \$54 million related predominantly to various intercompany transactions. The Company has recorded its best estimate of the potential exposure for these issues.

On February 18, 2014, the Company received a Notice of Deficiency ("NOD") from the IRS asserting that a non-taxable return of capital received from a subsidiary was a taxable dividend distribution. The NOD assesses additional taxes of \$70 million for the 2006 tax year, plus interest and penalties. In May 2014, the Company petitioned the United States Tax Court to challenge the NOD. The Company's petition was subsequently denied and the case will proceed to court. Although the outcome of this process cannot be predicted with certainty, the Company believes it will be successful in defending its positions. Accordingly, no reserve has been recorded related to this matter.

(4) Inventories

Inventories as of June 30, 2015 and December 31, 2014 were as follows:

In millions	June 30, 2015	December 31, 2014
Raw material	\$454	\$458
Work-in-process	142	133
Finished goods	683	677
LIFO reserve	(88)	(88)
Total inventories	\$1,191	\$1,180

(5) Pension and Other Postretirement Benefits

Pension and other postretirement benefit costs related to both continuing and discontinued operations for the three and six months ended June 30, 2015 and 2014, were as follows:

In millions	Three Months Ended June 30,				Six Months Ended June 30,			
	Pension		Other Postretirement Benefits		Pension		Other Postretirement Benefits	
	2015	2014	2015	2014	2015	2014	2015	2014
Components of net periodic benefit cost:								
Service cost	\$18	\$20	\$2	\$2	\$36	\$40	\$5	\$5
Interest cost	23	26	6	6	46	52	12	12
Expected return on plan assets	(38)	(39)	(6)	(6)	(76)	(79)	(12)	(12)
Amortization of actuarial (gain) loss	15	12	—	(1)	30	24	—	(3)
Settlement/curtailment (gain) loss	—	2	—	(9)	—	2	—	(9)
Net periodic benefit (income) cost	\$18	\$21	\$2	\$(8)	\$36	\$39	\$5	\$(7)
Amounts were included in the statement of income as follows:								
Continuing operations	\$18	\$18	\$2	\$1	\$36	\$34	\$5	\$2
Discontinued operations	—	3	—	(9)	—	5	—	(9)

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Net periodic benefit (income) cost	\$18	\$21	\$2	\$(8) \$36	\$39	\$5	\$(7)
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The Company expects to contribute approximately \$100 million to its pension plans and \$5 million to its other postretirement plans in 2015. As of June 30, 2015, contributions of \$89 million to pension plans and \$3 million to other postretirement plans have been made.

(6) Debt

Short-term debt as of June 30, 2015 and December 31, 2014 included commercial paper of \$805 million and \$1.4 billion, respectively.

In May 2015, the Company issued €500 million of 1.25% Euro notes due May 22, 2023 at 99.239% of face value and €500 million of 2.125% Euro notes due May 22, 2030 at 99.303% of face value. Net proceeds from the May 2015 debt issuances were used to repay commercial paper and for general corporate purposes. The Company designated the €1.0 billion of Euro notes as a hedge of a portion of its net investment in Euro-denominated foreign operations to reduce foreign currency risk associated with the investment in these operations. Changes in the value of this debt resulting from fluctuations in the Euro to U.S. Dollar exchange rate have been recorded as foreign currency translation adjustments within Accumulated other comprehensive income. Refer to the Accumulated other comprehensive income note for additional information regarding the net investment hedge.

The approximate fair value and related carrying value of the Company's total long-term debt, including current maturities of long-term debt presented as short-term debt, as of June 30, 2015 and December 31, 2014 were as follows:

In millions	June 30, 2015	December 31, 2014
Fair value	\$7,131	\$6,431
Carrying value	6,995	5,982

The approximate fair values of the Company's long-term debt, including current maturities, were based on a Level 2 valuation model, using observable inputs which included market rates for comparable instruments for the respective periods.

(7) Accumulated Other Comprehensive Income

The following table summarizes changes in Accumulated other comprehensive income for the three and six months ended June 30, 2015 and 2014:

In millions	Three Months Ended		Six Months Ended		
	June 30, 2015	2014	June 30, 2015	2014	
Beginning balance	\$(1,226	) \$420	\$(658	) \$384
Foreign currency translation adjustments during the period	153	82	(374	) 110
Foreign currency translation adjustments reclassified to income	—	(132) —	(132)
Income taxes	16	—	(34) —	
Total foreign currency translation adjustments	169	(50) (408) (22)
Pension and other postretirement benefit adjustments during the period	—	(41) (2) (41)
Pension and other postretirement benefit adjustments reclassified to income	15	19	30	29	

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Income taxes	(4) 11	(8) 9	
Total pension and other postretirement benefit adjustments	11	(11) 20	(3)
Ending balance	\$(1,046	) \$359	\$(1,046	) \$359

Foreign currency translation adjustments reclassified to income are primarily related to the disposal of certain discontinued operations. Refer to the Discontinued Operations note for additional information. Pension and other postretirement benefit

adjustments reclassified to income primarily relate to the amortization of actuarial (gain) loss and prior service cost. Refer to the Pension and Other Postretirement Benefits note for additional information.

The Company designated the €1.0 billion of Euro notes issued in May 2015 and the €1.0 billion of Euro notes issued in May 2014 as hedges of a portion of its net investment in Euro-denominated foreign operations to reduce foreign currency risk associated with the investment in these operations. The carrying values of the Euro notes were \$1.1 billion and \$1.1 billion, respectively, as of June 30, 2015. Changes in the value of this debt resulting from fluctuations in the Euro to U.S. dollar exchange rate have been recorded as foreign currency translation adjustments within Accumulated other comprehensive income. The unrealized gain recorded in Accumulated other comprehensive income related to the net investment hedge was \$250 million and \$158 million as of June 30, 2015 and December 31, 2014, respectively.

The ending balance of Accumulated other comprehensive income as of June 30, 2015 and 2014 consisted of cumulative translation adjustment expense of \$673 million and income of \$652 million, respectively, and unrecognized pension and other postretirement benefits costs, net of tax, of \$373 million and \$293 million, respectively.

(8) Segment Information

The Company has seven reportable segments: Automotive OEM; Test & Measurement and Electronics; Food Equipment; Polymers & Fluids; Welding; Construction Products; and Specialty Products. See Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations for information regarding operating revenue and operating income for the Company's segments.

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION

Founded in 1912, ITW is a multi-industry company with a strong portfolio of global industrial businesses including Automotive OEM, Test & Measurement and Electronics, Food Equipment, Polymers & Fluids, Welding, Construction Products and Specialty Products. The core source of value creation and competitive advantage is the ITW Business Model, consisting of the 80/20 business process, a customer-back approach to innovation and a decentralized entrepreneurial culture. Each ITW business leverages the ITW Business Model to deliver best-in-class financial performance. The Company has approximately 49,000 employees and operations in 57 countries.

THE ITW BUSINESS MODEL

The Company is built around a powerful and highly differentiated business model that comprises three elements:

80/20 Business Process - ITW's proprietary 80/20 business process focuses on what is most important (the 20% of the items which account for 80% of the value) in order to spend less time and resources on the less important (the 80% of the items which account for 20% of the value), resulting in improved financial performance.

The Company uses this 80/20 business process to simplify and focus on the key drivers of business profitability, and as a result, reduces complexity that creates unnecessary expense and disguises what is truly important. The Company utilizes the 80/20 process in all aspects of its business. Common applications of the 80/20 business process include:

- Simplifying product lines by reducing the number of products offered by combining the features of similar products, outsourcing products or eliminating low-value products.
- Segmenting the customer base by focusing on the 80/20 customers separately and finding alternative ways to serve the 20/80 customers.
- Simplifying the supplier base by partnering with 80/20 suppliers and reducing the number of 20/80 suppliers.
- Designing business processes, systems and measurements around the 80/20 activities.

Over the past three decades, the result of the application of the 80/20 business process is that the Company has improved its long-term operating and financial performance and believes that there is considerable future opportunity from the continuous disciplined application of 80/20. These 80/20 efforts can result in restructuring initiatives that reduce costs and improve profitability and returns.

Customer-Back Innovation - ITW's customer-back approach to innovation builds on the Company's 80/20 business process to help ITW businesses focus on the most profitable customers and invent solutions to solve their specific problems. ITW businesses are focused on building relationships with these major customers to develop deep knowledge and insight around their needs. These customer insights and learnings drive innovation at ITW and have contributed to a portfolio of approximately 16,000 granted and pending patents.

Decentralized Entrepreneurial Culture - At the core of ITW's culture is a desire to keep decision making and management responsibility close to customers in order to best meet their needs while rapidly adapting to changes in end markets. ITW businesses have significant flexibility within the framework of the ITW Business Model to customize their approach in order to best serve their customers. This leads to a focused and simple organizational structure that, combined with outstanding execution, delivers operational excellence adapted to their customers and end markets.

ENTERPRISE STRATEGY

In 2012, the Company embarked on a five-year Enterprise Strategy with the objective of positioning the Company to generate the maximum yield from the compelling performance potential that resides within the ITW Business Model. By doing so, the Company expects to generate solid growth with best-in-class margins and after-tax return on invested capital for the Company and sustainable long-term value creation for shareholders. With this objective in mind, the Company is committed to achieving the following performance goals by the end of 2017:

Organic Growth: 200 basis points above global GDP
Operating Margin: Approximately 23 percent
After-Tax ROIC: 20+ percent
Free Operating Cash Flow: 100 percent of net income

The Company has made significant progress toward these goals. The Enterprise Initiatives have helped build a foundation from which the Company is pivoting to a heightened focus on organic revenue growth. Since 2012, the Company has seen both operating margins and after-tax ROIC increase by approximately 500 basis points, with operating margin of 21.3 percent and after-tax ROIC of 20.3 percent in the second quarter of 2015.

KEY INITIATIVES

In conjunction with the Enterprise Strategy, the Company is in the process of implementing three key initiatives - portfolio management, business structure simplification, and strategic sourcing. These enterprise initiatives are expected to enhance the business through 2017 and are targeted at expanding organic revenue growth and improving profitability and returns to position ITW to deliver 12 to 14 percent annualized total shareholder return over the long-term, assuming global GDP of 3 percent.

Portfolio Management - The Company's portfolio management initiative aims to reposition the business portfolio to fully leverage the ITW Business Model. This initiative began with the divestiture of over 30 businesses that did not have the attributes necessary to fully leverage the ITW Business Model. As a result, the Company's divestiture activity increased in 2012, 2013 and 2014. With the sale of the Company's former Industrial Packaging segment on May 1, 2014, the divestiture element of the Company's portfolio management initiative is essentially complete.

The Company has historically acquired businesses with complementary products and services as well as larger acquisitions that represent potential new platforms. Going forward, the Company will emphasize organic growth, while acquisitions will be targeted to bolt-on acquisitions that support and accelerate organic growth in existing segments, and new platforms that expand the Company's long-term growth and earnings potential.

The focus of the portfolio repositioning efforts has now shifted from divestitures to significant efforts inside the Company's businesses to exit slower-growth product lines so that they can concentrate their efforts and resources on taking full advantage of their most compelling organic growth opportunities. Product line simplification (PLS) focuses on eliminating the complexity and overhead costs associated with smaller product lines and customers, and focuses businesses on supporting and growing their largest customers and product lines. In the short-term, product line simplification may result in a decrease in revenue and overhead costs while improving operating margin. Over the long-term, product line simplification results in growth in revenue, profitability and returns. PLS activities have resulted in approximately 100 basis points of organic revenue headwind in 2014 and 2015, as the Company strategically exits certain products and customer relationships. The impact of PLS is expected to moderate beginning in 2016.

Business Structure Simplification - The business structure simplification initiative simplifies the Company's organizational model and adds scale to the Company's operating divisions in order to fully leverage 80/20, increase organic revenue growth, enhance global competitiveness and drive operational efficiencies. This initiative focuses on consolidating the Company's operating structure from over 800 regional businesses into approximately 90 global divisions while retaining the positive attributes of a decentralized operating model. The Company expects to enhance its profitability and returns through a combination of applying its 80/20 business process to the new divisions, more focused growth investments and reduced infrastructure.

Strategic Sourcing - The Company's strategic sourcing initiative focuses on building sourcing capability in order to leverage purchasing scale to enhance profitability and global competitiveness. It incorporates both enterprise-level and segment-level purchasing that cross the Company's many businesses. The target is to reduce global spend by an average of one percent per year for the five-year period from 2013-2017. The Company has exceeded its annual targets in each of the past two years.

TERMS USED BY ITW

Management uses the following terms to describe the financial results of operations of the Company:

- Organic business - acquired businesses that have been included in the Company's results of operations for more than 12 months on a constant currency basis.
- Operating leverage - the estimated effect of the organic revenue volume changes on organic operating income, assuming variable margins remain the same as the prior period.
 - Changes in variable margins and overhead costs - represent the estimated effect of non-volume related changes in the operating income of organic businesses and may be driven by a number of factors, including changes in product mix, the cost of raw materials, labor and overhead, and pricing to customers.

Price/cost - represents the estimated net impact of increases or decreases in the cost of materials used in the Company's products versus changes in the selling price to the Company's customers. Price/cost is a component of changes in variable margins and overhead costs.

Product line simplification (PLS) - focuses businesses on eliminating the complexity and overhead costs associated with smaller product lines and customers, and focuses businesses on supporting and growing their largest customers and product lines; in the short-term, PLS may result in a decrease in revenue and overhead costs while improving operating margin. In the long-term, PLS results in growth in revenue, profitability, and returns.

Unless otherwise stated, the changes in financial results in the consolidated results of operations and the results of operations by segment represent the current year period versus the comparable period in the prior year. The discussion of operating results should be read in conjunction with Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's 2014 Annual Report on Form 10-K.

CONSOLIDATED RESULTS OF OPERATIONS

In the second quarter and year-to-date periods, the Company delivered solid earnings performance primarily driven by the execution of the Company's enterprise initiatives despite the weakening of foreign currencies against the U.S. dollar and a challenging macro environment.

The Company's consolidated results of operations for the second quarter and year-to-date periods were as follows:

Dollars in millions	Three Months Ended		Components of Increase (Decrease)						
	June 30,		Inc (Dec)	Organic	Acquisition/Divestitures	Restructuring	Foreign Currency	Total	
	2015	2014							
Operating revenue	\$3,434	\$3,719	(7.6)%	0.2 %	(0.3)%	—	(7.5)%	(7.6)%	
Operating income	\$730	\$763	(4.3)%	4.2 %	(0.5)%	(0.1)%	(7.9)%	(4.3)%	
Operating margin %	21.3 %	20.5 %	80 bps	80 bps	—	—	—	80 bps	

Dollars in millions	Six Months Ended		Components of Increase (Decrease)						
	June 30,		Inc (Dec)	Organic	Acquisition/Divestitures	Restructuring	Foreign Currency	Total	
	2015	2014							
Operating revenue	\$6,776	\$7,288	(7.0)%	0.4 %	(0.3)%	—	(7.1)%	(7.0)%	
Operating income	\$1,427	\$1,430	(0.3)%	7.5 %	(0.3)%	0.4 %	(7.9)%	(0.3)%	
Operating margin %	21.1 %	19.6 %	150 bps	140 bps	—	10 bps	—	150 bps	

Organic revenue increased 0.2% and 0.4% in the second quarter and year-to-date periods, respectively.

Automotive OEM, Food Equipment and Construction Products had solid worldwide organic revenue growth primarily due to product innovation, penetration gains and higher market demand. Organic revenue declined in the Welding, Test & Measurement and Electronics and Specialty Products segments as a result of the impact of a challenging

capital spending environment and lower demand in the oil and gas sector.

PLS activities associated with the portfolio management component of the Company's Enterprise Strategy reduced organic revenue growth by approximately one percentage point in both the second quarter and year-to-date periods. North American organic revenue increased 0.4% and 0.6% in the second quarter and year-to-date periods, respectively, as growth in the Automotive OEM, Food Equipment and Construction Products segments was partially offset by a decline in the Welding, Test & Measurement and Electronics and Specialty Products segments.

Europe, Middle East and Africa organic revenue increased 2.0% and 1.7% in the second quarter and year-to-date periods, respectively. Growth in the Automotive OEM, Food Equipment, and Welding segments was partially offset by a decline in the Polymers & Fluids, Test & Measurement and Electronics and Specialty Products segments.

Asia Pacific organic revenue decreased 2.5% and 0.8% in the second quarter and year-to-date periods, respectively, primarily due to a decline in the Welding and Test & Measurement and Electronics segments, partially offset by growth in the Construction Products and Polymers & Fluids segments.

Operating revenue decreased in the second quarter and year-to-date periods primarily due to the unfavorable effect of foreign currency translation as the U.S. dollar strengthened against most major currencies. In the year-to-date period, operating revenue declined \$512 million while operating income was essentially flat.

Operating margin of 21.3% and 21.1% in the second quarter and year-to-date periods, respectively, increased 80 and 150 basis points versus the prior year. The primary driver of the operating margin improvement was the benefit of the Company's enterprise initiatives related to strategic sourcing and business structure simplification that contributed 100 basis points in each respective period. Favorable price/cost of 20 basis points in both comparable periods was offset by the lower operating margin in the Specialty Products segment in the second quarter.

Diluted earnings per share (EPS) from continuing operations of \$1.30 for the second quarter increased 7.4%. The unfavorable effect of foreign currency translation decreased second quarter EPS by approximately \$0.12 per diluted share, or 10%. In the year-to-date period, EPS from continuing operations of \$2.51 increased 13.1%. The unfavorable effect of currency translation decreased year-to-date EPS by approximately \$0.21 per diluted share, or 10%.

The Company repurchased approximately 1.9 million and 18.4 million shares of its common stock in the second quarter and year-to-date periods, respectively, for approximately \$184 million and \$1.8 billion, respectively.

Free operating cash flow was \$384 million, or 80% of net income, for the second quarter. In the year-to-date period, free operating cash flow was \$743 million, or 79% of net income.

Adjusted return on average invested capital was 20.3% for the second quarter, an increase of 80 basis points, and 19.7% in the year-to-date period, an increase of 130 basis points.

RESULTS OF OPERATIONS BY SEGMENT

Total operating revenue and operating income for the second quarter and year-to-date periods were as follows:

Dollars in millions	Three Months Ended June 30,				Six Months Ended June 30,			
	Operating Revenue		Operating Income		Operating Revenue		Operating Income	
	2015	2014	2015	2014	2015	2014	2015	2014
Automotive OEM	\$649	\$671	\$159	\$158	\$1,302	\$1,339	\$322	\$314
Test & Measurement and Electronics	496	558	79	85	979	1,077	150	148
Food Equipment	518	537	114	105	1,013	1,048	226	200
Polymers & Fluids	446	506	94	99	887	985	182	179
Welding	426	470	111	124	859	933	228	243
Construction Products	419	444	84	81	800	860	147	142
Specialty Products	486	540	115	130	948	1,060	219	239
Intersegment revenues	(6)	(7)	—	—	(12)	(14)	—	—
Unallocated	—	—	(26)	(19)	—	—	(47)	(35)
Total	\$3,434	\$3,719	\$730	\$763	\$6,776	\$7,288	\$1,427	\$1,430

AUTOMOTIVE OEM

Businesses in this segment produce components and fasteners for automotive-related applications.

In the Automotive OEM segment, products and services include:

plastic and metal components, fasteners and assemblies for automobiles, light trucks, and other industrial uses.

This segment primarily serves the automotive original equipment manufacturers and tiers market.

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The results of operations for the Automotive OEM segment for the second quarter and year-to-date periods were as follows:

Dollars in millions	Three Months Ended		Components of Increase (Decrease)							Total
	June 30,		Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Exchange			
	2015	2014								
Operating revenue	\$649	\$671	(3.4)%	6.0 %	(0.3)%	—	(9.1)%	(3.4)%		
Operating income	\$159	\$158	0.1 %	9.1 %	(0.1)%	—	(8.9)%	0.1 %		
Operating margin %	24.5 %	23.7 %	80 bps	70 bps	10 bps	—	—	80 bps		
Dollars in millions	Six Months Ended		Components of Increase (Decrease)							Total
	June 30,		Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Exchange			
	2015	2014								
Operating revenue	\$1,302	\$1,339	(2.7)%	6.3 %	(0.4)%	—	(8.6)%	(2.7)%		
Operating income	\$322	\$314	2.6 %	11.5 %	(0.1)%	0.2	(9.0)%	2.6 %		
Operating margin %	24.8 %	23.5 %	130 bps	110 bps	—	20 bps	—	130 bps		

As a result of product innovation and penetration gains, worldwide automotive organic revenue grew 6.0% and 6.3% for the second quarter and year-to-date periods, respectively, exceeding worldwide auto builds which were flat for the second quarter and grew 1% in the year-to-date period.

European organic revenue growth of 10.4% and 11.5% for the second quarter and year-to-date periods, respectively, exceeded auto builds that were flat for the second quarter and grew 2% in the year-to-date period.

North American organic revenue grew 4.9% and 4.1% for the second quarter and year-to-date periods, respectively.

North American auto builds grew 2% in each respective period as auto builds for the Detroit 3 grew 1% in the second quarter and declined 1% in the year-to-date period.

Asia Pacific organic revenue was essentially flat in the second quarter and increased 2.5% year-to-date. Organic revenue growth in China of 8.0% and 11.0% in the second quarter and year-to-date periods, respectively, exceeded Chinese auto build growth of 2% and 5% versus the respective prior year periods.

Operating revenue decreased in the second quarter and year-to-date periods primarily due to the unfavorable effect of currency translation.

Operating margin in the second quarter was 24.5%, an increase of 80 basis points primarily driven by positive operating leverage of 90 basis points. In the year-to-date period, operating margin increased 130 basis points to 24.8% primarily driven by positive operating leverage of 90 basis points, the net benefits from the Company's enterprise initiatives and cost management, and lower restructuring expenses.

TEST & MEASUREMENT AND ELECTRONICS

Businesses in this segment produce equipment, consumables, and related software for testing and measuring of materials and structures, as well as equipment and consumables used in the production of electronic subassemblies

and microelectronics.

In the Test & Measurement and Electronics segment, products include:

- equipment, consumables, and related software for testing and measuring of materials, structures, gases and fluids;
- electronic assembly equipment and related consumable solder materials;
- electronic components and component packaging;
 - static control equipment and consumables used for contamination control in clean room environments; and
- pressure sensitive adhesives and components for telecommunications, electronics, medical and transportation applications.

This segment primarily serves the electronics, general industrial, industrial capital goods, automotive original equipment manufacturers and tiers and consumer durables markets.

The results of operations for the Test & Measurement and Electronics segment for the second quarter and year-to-date periods were as follows:

Dollars in millions	Three Months Ended		Components of Increase (Decrease)						
	June 30,		Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Exchange	Total	
	2015	2014							
Operating revenue	\$496	\$558	(11.0)%	(4.9)%	—	%	—	%(6.1)%	(11.0)%
Operating income	\$79	\$85	(6.0)%	(3.5)%	—	%	4.2	%(6.7)%	(6.0)%
Operating margin %	16.1	% 15.2	% 90 bps	20 bps	—		70 bps	—	90 bps
Dollars in millions	Six Months Ended		Components of Increase (Decrease)						
	June 30,		Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Exchange	Total	
	2015	2014							
Operating revenue	\$979	\$1,077	(9.0)%	(3.0)%	—	%	—	%(6.0)%	(9.0)%
Operating income	\$150	\$148	1.7 %	5.1 %	—	%	4.0	%(7.4)%	1.7 %
Operating margin %	15.4	% 13.8	% 160 bps	120 bps	—		50 bps	(10) bps	160 bps

Organic revenue decreased 4.9% and 3.0% for the second quarter and year-to-date periods, respectively.

Organic revenue for the worldwide test and measurement businesses decreased 6.7% and 4.2% for the second quarter and year-to-date periods, respectively, primarily due to the impact of a challenging capital spending environment.

Worldwide electronics organic revenue declined 2.6% and 1.4% for the second quarter and year-to-date periods, respectively. Weaker demand in the electronic assembly businesses was partially offset by increased revenues in the other electronics businesses, which include the pressure sensitive adhesives, contamination control and electrostatics businesses, driven by increased demand in North America and Europe.

Operating revenue decreased in the second quarter and year-to-date periods due to the unfavorable effect of currency translation and the decrease in organic revenue.

Operating margin was 16.1% in the second quarter of 2015, an increase of 90 basis points driven by the net benefits resulting from the Company's enterprise initiatives and cost management of 150 basis points, lower restructuring expenses of 70 basis points and favorable price/cost of 30 basis points, partially offset by negative operating leverage of 160 basis points.

In the year-to-date period, operating margin increased 160 basis points to 15.4% primarily driven by the net benefits resulting from the Company's enterprise initiatives and cost management of 190 basis points, lower restructuring expenses of 50 basis points and favorable price/cost of 20 basis points, partially offset by negative operating leverage of 90 basis points.

FOOD EQUIPMENT

Businesses in this segment produce commercial food equipment and related service.

In the Food Equipment segment, products and services include:

- warewashing equipment;
- cooking equipment, including ovens, ranges and broilers;
- refrigeration equipment, including refrigerators, freezers and prep tables;
- food processing equipment, including slicers, mixers and scales;
- kitchen exhaust, ventilation and pollution control systems; and
- food equipment service, maintenance and repair.

This segment primarily serves the food institutional/restaurant, food service and food retail markets.

The results of operations for the Food Equipment segment for the second quarter and year-to-date periods were as follows:

Dollars in millions	Three Months Ended										
	June 30,		Components of Increase (Decrease)								Total
	2015	2014	Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Exchange				
Operating revenue	\$518	\$537	(3.6)%	4.2 %	— %	— %	— %	(7.8)%	(3.6)%		
Operating income	\$114	\$105	8.9 %	22.3 %	— %	— %	(5.0)%	(8.4)%	8.9 %		
Operating margin %	22.0 %	19.5 %	250 bps	340 bps	—	—	(90) bps	—	250 bps		
Dollars in millions	Six Months Ended										
	June 30,		Components of Increase (Decrease)								Total
	2015	2014	Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Exchange				
Operating revenue	\$1,013	\$1,048	(3.4)%	4.1 %	— %	— %	— %	(7.5)%	(3.4)%		
Operating income	\$226	\$200	13.0 %	21.2 %	— %	— %	— %	(8.2)%	13.0 %		
Operating margin %	22.3 %	19.1 %	320 bps	320 bps	—	—	—	—	320 bps		

Organic revenue increased 4.2% and 4.1% for the second quarter and year-to-date periods, respectively. North American organic revenue increased 7.1% and 7.2% for the second quarter and year-to-date periods, respectively. North American equipment revenue increased 8.9% and 9.2% in the second quarter and year-to-date periods, respectively, primarily due to product innovation and improved market penetration in the warewash, refrigeration and cooking businesses. Service revenue in North America increased 4.6% and 4.3% in the second quarter and year-to-date periods, respectively. International organic revenue increased 1.1% in the second quarter and 0.8% in the year-to-date period primarily due to growth in Europe. International equipment revenue, which had a more challenging comparable in the prior year, increased 0.4% in the second quarter and year-to-date periods. International service organic revenue increased 2.8% and 2.0% in the second quarter and year-to-date periods, respectively. Operating revenue decreased in the second quarter and year-to-date periods due to the unfavorable effect of currency translation. Operating margin in the second quarter was 22.0%. The 250 basis point improvement was driven by the net benefits of the Company's enterprise initiatives and cost management of 210 basis points, positive operating leverage of 100 basis points and favorable price/cost of 30 basis points, partially offset by higher restructuring expenses of 90 basis points. In the year-to-date period, operating margin increased 320 basis points to 22.3%. Operating margin improved due to the net benefits of the Company's enterprise initiatives and cost management of 190 basis points, positive operating leverage of 110 basis points and favorable price/cost of 20 basis points.

POLYMERS & FLUIDS

Businesses in this segment produce adhesives, sealants, lubrication and cutting fluids, janitorial and hygiene products, and fluids and polymers for auto aftermarket maintenance and appearance.

In the Polymers & Fluids segment, products include:

- adhesives for industrial, construction and consumer purposes;
- chemical fluids which clean or add lubrication to machines;
- epoxy and resin-based coating products for industrial applications;
- hand wipes and cleaners for industrial applications;
- fluids, polymers and other supplies for auto aftermarket maintenance and appearance;
- fillers and putties for auto body repair; and
- polyester coatings and patch and repair products for the marine industry.

This segment primarily serves the automotive aftermarket, general industrial, maintenance, repair and operations or “MRO”, and construction markets.

The results of operations for the Polymers & Fluids segment for the second quarter and year-to-date periods were as follows:

Dollars in millions	Three Months Ended										
	June 30,		Components of Increase (Decrease)								Total
	2015	2014	Inc (Dec)	Organic	Acquisition/Divestitures	Restructuring	Foreign Exchange				
Operating revenue	\$446	\$506	(11.9)%	(1.6)%	(1.6)%	—	%	(8.7)%	(11.9)%		
Operating income	\$94	\$99	(5.8)%	0.5 %	(3.5)%	4.8	%	(7.6)%	(5.8)%		
Operating margin %	20.9 %	19.6 %	130 bps	40 bps	(40) bps	100 bps		30 bps	130 bps		
Dollars in millions	Six Months Ended										
	June 30,		Components of Increase (Decrease)								Total
	2015	2014	Inc (Dec)	Organic	Acquisition/Divestitures	Restructuring	Foreign Exchange				
Operating revenue	\$887	\$985	(10.0)%	(1.0)%	(0.8)%	—	%	(8.2)%	(10.0)%		
Operating income	\$182	\$179	1.5 %	7.5 %	(1.9)%	3.8	%	(7.9)%	1.5 %		
Operating margin %	20.5 %										