

ILLINOIS TOOL WORKS INC  
Form 10-K  
February 12, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

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

For the fiscal year ended December 31, 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	(I.R.S. Employer
Incorporation or Organization)	Identification No.)

155 Harlem Avenue, Glenview, Illinois	60025
(Address of Principal Executive Offices)	(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock	New York Stock Exchange
1.75% Euro Notes due 2022	New York Stock Exchange
1.25% Euro Notes due 2023	New York Stock Exchange
2.125% Euro Notes due 2030	New York Stock Exchange
3.00% Euro Notes due 2034	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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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 company" in Rule 12b-2 of the Exchange Act. (Check one):

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 aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2015 was approximately \$26.7 billion based on the New York Stock Exchange closing sales price as of June 30, 2015.

Shares of Common Stock outstanding at January 31, 2016: 363,766,897.

Documents Incorporated by Reference

Portions of the 2016 Proxy Statement for Annual Meeting of Stockholders to be held on May 6, 2016.

Part III

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## PART I

### ITEM 1. Business

#### General

Illinois Tool Works Inc. (the "Company" or "ITW") was founded in 1912 and incorporated in 1915. The Company's ticker symbol is ITW. The Company is a global manufacturer of a diversified range of industrial products and equipment with 84 divisions in 57 countries. As of December 31, 2015, the Company employed approximately 48,000 persons.

The Company's operations are organized and managed based on similar product offerings and similar end markets, and are reported to senior management as the following seven segments: Automotive OEM; Test & Measurement and Electronics; Food Equipment; Polymers & Fluids; Welding; Construction Products; and Specialty Products. The following is a description of the Company's seven segments:

**Automotive OEM:** This segment is a global, niche supplier to top tier OEMs, providing unique innovation to address pain points for sophisticated customers with complex problems. Businesses in this segment produce components and fasteners for automotive-related applications. This segment primarily serves the automotive original equipment manufacturers and tiers market. Products in this segment include:

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

**Test & Measurement and Electronics:** This segment is a branded and innovative producer of test and measurement and electronic manufacturing and maintenance, repair, and operations, or "MRO" solutions that improve efficiency and quality for customers in diverse end markets. 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. This segment primarily serves the electronics, general industrial, industrial capital goods, automotive original equipment manufacturers and tiers, and consumer durables markets. Products in this segment 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.

**Food Equipment:** This segment is a highly focused and branded industry-leader in commercial food equipment differentiated by innovation and integrated service offerings. This segment primarily serves the food institutional/restaurant, food service and food retail markets. Products in this segment 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.

Polymers & Fluids: This segment is a highly branded supplier to niche markets that require value-added, differentiated products. Businesses in this segment produce adhesives, sealants, lubrication and cutting fluids, and fluids and polymers for auto aftermarket maintenance and appearance. This segment primarily serves the automotive aftermarket, general industrial, MRO, and construction markets. Products in this segment 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.

**Welding:** This segment is a branded value-added equipment and specialty consumable manufacturer with innovative and leading technology. Businesses in this segment produce arc welding equipment, consumables and accessories for a wide array of industrial and commercial applications. This segment primarily serves the general industrial market, which includes fabrication, shipbuilding and other general industrial markets, and energy, MRO, construction, and industrial capital goods markets. Products in this segment include:

- arc welding equipment;
- metal arc welding consumables and related accessories; and
- metal jacketing and other insulation products.

**Construction Products:** This segment is a branded supplier of innovative engineered fastening systems and solutions. This segment primarily serves the residential construction, renovation/remodel construction and commercial construction markets. Products in this segment include:

- fasteners and related fastening tools for wood and metal applications;
- anchors, fasteners and related tools for concrete applications;
- metal plate truss components and related equipment and software; and
- packaged hardware, fasteners, anchors and other products for retail.

**Specialty Products:** This segment is focused on diversified niche market opportunities that deliver strong operating results with substantial patent protection producing beverage packaging equipment and consumables, product coding and marking equipment and consumables, and appliance components and fasteners. This segment primarily serves the food and beverage, consumer durables, general industrial, printing and publishing and industrial capital goods markets. Products in this segment include:

- line integration, conveyor systems and line automation for the food and beverage industries;
- plastic consumables that multi-pack cans and bottles and related equipment;
- foil, film and related equipment used to decorate consumer products;
- product coding and marking equipment and related consumables;
- plastic and metal fasteners and components for appliances;
- airport ground support equipment; and
- components for medical devices.

The information set forth below is applicable to all segments of the Company unless otherwise noted.

#### The ITW Business Model

The powerful and highly differentiated ITW Business Model is the Company's core source of value creation. This business model is the Company's competitive advantage and defines how ITW creates value for its shareholders and comprises three unique elements:

ITW's 80/20 management process is the operating system that is applied in every ITW business. Initially introduced as a manufacturing efficiency tool in the 1980's, ITW has continually refined, improved and expanded 80/20 into a proprietary, holistic business management process that generates significant value for the Company. Through the application of data-driven insights generated by 80/20 practice, ITW focuses on its largest and best opportunities (the "80") and eliminates complexity associated with the less profitable opportunities (the "20"). 80/20 enables ITW businesses to consistently deliver world-class operational excellence in regards to product availability, quality, and innovation,

while generating superior financial performance;

Customer-back innovation has fueled decades of profitable growth at ITW. The Company's unique innovation approach is built on the insight gathered from the 80/20 management process. Working from the customer back, ITW businesses position themselves as the go-to problem solver for their "80" customers. ITW's innovation efforts are focused on understanding customer needs, particularly those in "80" markets with solid long-term growth fundamentals, and then creating unique solutions to address those needs. These customer insights and learnings drive innovation at ITW and have contributed to a portfolio of more than 16,000 granted and pending patents;

ITW's decentralized, entrepreneurial culture allows ITW businesses to be fast, focused, and responsive. ITW businesses have significant flexibility within the framework of the ITW Business Model to customize their approach in order to best serve their customers. ITW colleagues are clear about what is expected of them with regard to ITW's business model, strategy, and values. This leads to a focused and simple organizational structure that, combined with outstanding execution, delivers operational excellence adapted to their specific customers and end markets.

### Enterprise Strategy

In 2013, ITW began the process of transitioning the Company onto its current strategic path to fully leverage the compelling performance potential of the ITW Business Model. Since then, ITW has made considerable progress, as evidenced by the Company's strong financial performance over the past three years.

The roots of ITW's Enterprise Strategy began in 2011-2012, when the Company undertook a complete review of its performance. ITW gathered deep insights from its businesses that were delivering consistent above-market growth with best-in-class margins and returns, and defined a strategy to replicate that performance throughout the Company.

Based on this rigorous and thorough evaluation, ITW determined two paths to deliver world-class financial performance and compelling long-term returns for its shareholders. One, ITW needed to shift the Company's primary growth engine to organic; and two, the Company needed to leverage the ITW Business Model to deliver best-in-class margins and returns.

### Shift the Company's Core Growth Engine to Organic

In order to pivot to fully focus on organic growth, the Company needed to first accomplish several preparatory steps. These key initiatives were a major focus of the Company in 2012-2015, which included portfolio management, business structure simplification and strategic sourcing.

The first step, portfolio management, was to construct and maintain a business portfolio capable of delivering consistent above-market organic growth. As part of this initiative to realign the portfolio, ITW exited businesses that were operating in commoditized market spaces and prioritized sustainable differentiation as a must-have requirement for all ITW businesses. This process included both divesting entire businesses and exiting commoditized product lines and customers inside otherwise highly differentiated ITW divisions.

As a result of this work, ITW's business portfolio now has significantly higher organic growth potential. ITW segments and divisions now possess attractive and differentiated product lines and end markets as they continue to improve margins and generate price/cost increases. This was achieved through product line simplification which 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. Most of this initiative is complete and ITW businesses are demonstrating notably improved financial performance; the Company expects the remaining product line simplification work to largely be accomplished in 2016.

The second step, business structure simplification, was to scale-up ITW's operating structure to support increased engineering, marketing, and sales resources, and to improve global reach and competitiveness, all of which were critical to ITW's ability to drive accelerated organic growth. ITW now has 84 scaled-up divisions with significantly enhanced focus on growth investments, core customers and products, and customer-back innovation.

With the portfolio realignment and scale-up work largely complete, the Company is now able to shift its focus to preparing for, and accelerating, organic growth.



As a third preparatory step, ITW is currently in the process of reapplying 80/20 to optimize its newly scaled-up divisions for growth. This process involves first using 80/20 to build a foundation of operational excellence, and then applying 80/20-driven insights to identify the best opportunities to drive organic growth.

Once the business is operationally excellent and has identified the right growth opportunities, the final step is to accelerate organic growth. The process of preparing for accelerated organic growth generally takes 18 to 24 months.

Based on the financial performance of the divisions that are further along in this process, the Company believes that this framework is capable of delivering above market organic growth in all ITW segments. Many ITW divisions are ready to grow and growing above their respective markets, while the rest of the Company's divisions are at various phases of

preparing to grow. ITW management is fully aligned on this plan and very focused on executing it. By the end of 2016, the Company expects approximately 85 percent of its businesses to be ready to grow.

#### Leverage the ITW Business Model to Deliver Best-in-Class Margins and Returns

The Company's work to deliver best-in-class margins and returns is focused on two key areas of ongoing activity. The first is strategic sourcing, where the Company seeks to benefit from its size and scale in procurement processes. Sourcing is now a core strategic and operational capability and this improved competitiveness supports ITW's organic growth framework. The Company's 80/20-enabled sourcing organization has delivered an average of 1 percent reduction in spend each year in 2013-2015 and is on track to do the same in 2016 and 2017.

The second element of the margins and returns area of focus is to better leverage the full power of the ITW Business Model through a much more consistent and focused approach to 80/20 best practice implementation across the Company. ITW has clearly defined what excellence in the practice of ITW's 80/20 management process looks like and the result is significant opportunity to create meaningful incremental improvement in margins and returns as evidenced by the Company's improvement in both operating margin and after-tax return on invested capital. These 80/20 initiatives can result in restructuring initiatives that reduce costs and improve profitability and returns.

#### Divestiture of Majority Interest in Former Decorative Surfaces Segment

On October 31, 2012, the Company divested a 51% majority interest in the Decorative Surfaces segment. Accordingly, the Company ceased consolidating the results of the Decorative Surfaces segment as of October 31, 2012 and now reports its 49% ownership interest using the equity method of accounting. Due to the Company's continuing involvement through its 49% interest, the historical operating results of Decorative Surfaces are presented in continuing operations. Effective November 1, 2012, Decorative Surfaces was no longer a reportable segment of the Company.

#### Divestiture of the Industrial Packaging Segment

In February 2013, the Company announced that it was initiating a review process to explore strategic alternatives for the Industrial Packaging segment. In September 2013, the Company's Board of Directors authorized a plan to commence a sale process for the Industrial Packaging segment. The Company classified the Industrial Packaging segment as held for sale beginning in the third quarter of 2013 and no longer presented this segment as part of its continuing operations.

On February 6, 2014, the Company announced that it had signed a definitive agreement to sell the Industrial Packaging business to The Carlyle Group for \$3.2 billion. The transaction was completed on May 1, 2014, resulting in a pre-tax gain of \$1.7 billion (\$1.1 billion after-tax) in the second quarter of 2014 which was included in Income from discontinued operations.

See the Discontinued Operations note in Item 8. Financial Statements and Supplementary Data for further discussion of this transaction.

#### Current Year Developments

Refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### Financial Information about Segments

Segment and operating results are included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and the Segment Information note in Item 8. Financial Statements and Supplementary Data.

#### Distribution Methods

The Company's businesses primarily distribute their products directly to industrial manufacturers and through independent distributors.

## Backlog

Backlog generally is not considered a significant factor in the Company's businesses as relatively short delivery periods and rapid inventory turnover are characteristic of most of their products. Backlog by segment as of December 31, 2015 and 2014 was as follows:

In millions	2015	2014
Automotive OEM	\$403	\$414
Test & Measurement and Electronics	289	301
Food Equipment	203	237
Polymers & Fluids	53	60
Welding	68	84
Construction Products	34	28
Specialty Products	237	263
Total	\$1,287	\$1,387

Backlog orders scheduled for shipment beyond calendar year 2016 were not material as of December 31, 2015.

## Competition

With operations in 57 countries, the Company offers a wide range of products in a myriad of markets, many of which are fragmented, and the Company encounters a variety of competitors that vary by product line, end market and geographic area. The Company's competitors include many regional or specialized companies, as well as large U.S. and non-U.S. companies or divisions of large companies. Each of the Company's segments generally has several main competitors and numerous smaller ones in most of their end markets and geographic areas. In addition to numerous smaller regional competitors, the Welding segment competes globally with Lincoln Electric and ESAB.

In virtually all segments, the Company differentiates its businesses from its competitors based on product innovation, product quality, brand preference, service delivery and price. Technical capability is also a competitive factor in most segments. The Company believes that each segment's primary competitive advantages derive from the Company's business model and decentralized operating structure, which creates a strong focus on end markets and customers at the local level, enabling its businesses to respond rapidly to market dynamics. This structure enables the Company's businesses to drive operational excellence utilizing the Company's 80/20 management process and leveraging its product innovation capabilities. The Company also believes that its global footprint is a competitive advantage in many of its markets, especially in its Automotive OEM segment.

## Raw Materials

The Company uses raw materials of various types, primarily steel, resins, chemicals and paper, that are available from numerous commercial sources. The availability of materials and energy has not resulted in any significant business interruptions or other major problems, and no such problems are currently anticipated.

## Research and Development

Developing new and improved products, broadening the application of established products, and continuing efforts to improve and develop new methods, processes and equipment all contribute to the Company's organic growth. Many new products are designed to reduce customers' costs by eliminating steps in their manufacturing processes, reducing the number of parts in an assembly or improving the quality of customers' assembled products. Typically, the development of such products is accomplished by working closely with customers on specific applications. Research

and development expenses were \$218 million in 2015, \$227 million in 2014 and \$240 million in 2013.

#### Intellectual Property

The Company owns approximately 3,400 unexpired U.S. patents and 7,200 foreign patents covering articles, methods and machines. In addition, the Company has approximately 1,500 applications for patents pending in the U.S. Patent Office and

4,500 applications pending in foreign patent offices. There is no assurance that any of these patents will be issued. The Company maintains a patent group for the administration of patents and processing of patent applications.

The Company believes that many of its patents are valuable and important; however, the expiration of any one of the Company's patents would not have a material effect on the Company's results of operations or financial position. The Company also credits its success in the markets it serves to engineering capability; manufacturing techniques; skills and efficiency; marketing and sales promotion; and service and delivery of quality products to its customers.

In addition to patents, many of the Company's products and services are sold under various owned or licensed trademarks, which are important to the Company in the aggregate. Some of the Company's more significant trademarks include ITW, which is also used in conjunction with the trademarks of many of the Company's businesses; Deltar and Shakeproof in the Automotive OEM segment; Instron in the Test & Measurement and Electronics segment; Hobart in the Food Equipment segment; Permatex and Wynn's in the Polymers & Fluids segment; Miller in the Welding segment; Paslode in the Construction Products segment; and Hi-Cone in the Specialty Products segment.

#### Environmental

The Company believes that its manufacturing plants and equipment are in substantial compliance with all applicable environmental regulations. Additional measures to maintain compliance are not expected to materially affect the Company's capital expenditures, competitive position, financial position or results of operations.

Various legislative and administrative regulations concerning environmental issues have become effective or are under consideration in many parts of the world relating to manufacturing processes and the sale or use of certain products. To date, such developments have not had a substantial adverse impact on the Company's revenues, earnings or cash flows.

#### Employees

The Company employed approximately 48,000 persons as of December 31, 2015 and considers its employee relations to be excellent.

#### International

The Company's international operations include subsidiaries and joint ventures in 56 foreign countries on six continents. These operations serve such end markets as automotive OEM/tiers, automotive aftermarket, general industrial, commercial food equipment, construction, and others on a worldwide basis. The Company's revenues from sales to customers outside the U.S. were approximately 54% of revenues in 2015 and 57% of revenues in 2014 and 2013.

Refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and the Segment Information note in Item 8. Financial Statements and Supplementary Data for additional information on international activities. International operations are subject to certain potential risks inherent in conducting business in foreign countries, including price controls, exchange controls, limitations on participation in local enterprises, nationalization, expropriation and other governmental action, and fluctuations in currency exchange rates. Additional risks of the Company's international operations are described under Item 1A. Risk Factors.

Executive Officers

Executive Officers of the Company as of February 11, 2016 were as follows:

Name	Office	Age
E. Scott Santi	Chairman & Chief Executive Officer	54