

# Section 1: 10-Q (10-Q)

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 March 31, 2018

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

(State or other jurisdiction of incorporation or organization)

155 Harlem Avenue, Glenview, IL

(Address of principal executive offices)

36-1258310

(I.R.S. Employer Identification Number)

60025

(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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 March 31, 2018: 338,762,621.

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**PART I – FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

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

<b>In millions except per share amounts</b>	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Operating Revenue	\$ 3,744	\$ 3,471
Cost of revenue	2,181	2,003
Selling, administrative, and research and development expenses	612	608
Amortization and impairment of intangible assets	48	53
Operating Income	903	807
Interest expense	(66)	(64)
Other income (expense)	12	6
Income Before Taxes	849	749
Income Taxes	197	213
Net Income	\$ 652	\$ 536
Net Income Per Share:		
Basic	\$ 1.92	\$ 1.55
Diluted	\$ 1.90	\$ 1.54
Cash Dividends Per Share:		
Paid	\$ 0.78	\$ 0.65
Declared	\$ 0.78	\$ 0.65
Shares of Common Stock Outstanding During the Period:		
Average	340.2	346.2
Average assuming dilution	342.8	349.0

*The Notes to Financial Statements are an integral part of this statement.*

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

<b>In millions</b>	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
Net Income	\$ 652	\$ 536
Other Comprehensive Income (Loss):		
Foreign currency translation adjustments, net of tax	83	154
Pension and other postretirement benefit adjustments, net of tax	9	10
Comprehensive Income	<u>\$ 744</u>	<u>\$ 700</u>

*The Notes to Financial Statements are an integral part of this statement.*

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

In millions except per share amounts	March 31, 2018	December 31, 2017
<b>Assets</b>		
Current Assets:		
Cash and equivalents	\$ 1,940	\$ 3,094
Trade receivables	2,874	2,628
Inventories	1,335	1,220
Prepaid expenses and other current assets	274	336
Total current assets	6,423	7,278
Net plant and equipment	1,829	1,778
Goodwill	4,795	4,752
Intangible assets	1,226	1,272
Deferred income taxes	658	505
Other assets	1,232	1,195
	\$ 16,163	\$ 16,780
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities:		
Short-term debt	\$ 660	\$ 850
Accounts payable	655	590
Accrued expenses	1,250	1,258
Cash dividends payable	264	266
Income taxes payable	96	89
Total current liabilities	2,925	3,053
Noncurrent Liabilities:		
Long-term debt	6,889	7,478
Deferred income taxes	689	164
Noncurrent income taxes payable	614	614
Other liabilities	883	882
Total noncurrent liabilities	9,075	9,138
Stockholders' Equity:		
Common stock (par value of \$0.01 per share):		
Issued- 550.0 shares in 2018 and 2017		
Outstanding- 338.8 shares in 2018 and 341.5 shares in 2017	6	6
Additional paid-in-capital	1,220	1,218
Retained earnings	20,228	20,210
Common stock held in treasury	(16,055)	(15,562)
Accumulated other comprehensive income (loss)	(1,240)	(1,287)
Noncontrolling interest	4	4
Total stockholders' equity	4,163	4,589
	\$ 16,163	\$ 16,780

*The Notes to Financial Statements are an integral part of this statement.*

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

<b>In millions</b>	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash Provided by (Used for) Operating Activities:</b>		
Net income	\$ 652	\$ 536
<b>Adjustments to reconcile net income to cash provided by operating activities:</b>		
Depreciation	67	61
Amortization and impairment of intangible assets	48	53
Change in deferred income taxes	(5)	20
Provision for uncollectible accounts	1	1
(Income) loss from investments	(3)	(2)
(Gain) loss on sale of plant and equipment	(1)	—
Stock-based compensation expense	9	9
Other non-cash items, net	4	1
<b>Change in assets and liabilities, net of acquisitions and divestitures:</b>		
<b>(Increase) decrease in-</b>		
Trade receivables	(192)	(148)
Inventories	(68)	(67)
Prepaid expenses and other assets	(29)	(23)
<b>Increase (decrease) in-</b>		
Accounts payable	55	56
Accrued expenses and other liabilities	(90)	(117)
Income taxes	90	81
Other, net	—	2
Net cash provided by operating activities	<u>538</u>	<u>463</u>
<b>Cash Provided by (Used for) Investing Activities:</b>		
Acquisition of businesses (excluding cash and equivalents) and additional interest in affiliates	—	(3)
Additions to plant and equipment	(94)	(64)
Proceeds from investments	5	7
Proceeds from sale of plant and equipment	2	3
Other, net	(2)	—
Net cash provided by (used for) investing activities	<u>(89)</u>	<u>(57)</u>
<b>Cash Provided by (Used for) Financing Activities:</b>		
Cash dividends paid	(266)	(226)
Issuance of common stock	10	18
Repurchases of common stock	(500)	(250)
Net proceeds from (repayments of) debt with original maturities of three months or less	(840)	671
Repayments of debt with original maturities of more than three months	—	(652)
Other, net	(12)	(11)
Net cash provided by (used for) financing activities	<u>(1,608)</u>	<u>(450)</u>
Effect of Exchange Rate Changes on Cash and Equivalents	<u>5</u>	<u>65</u>
<b>Cash and Equivalents:</b>		
Increase (decrease) during the period	(1,154)	21
Beginning of period	3,094	2,472
End of period	<u>\$ 1,940</u>	<u>\$ 2,493</u>
<b>Supplementary Cash and Non-Cash Information:</b>		
Cash Paid During the Period for Interest	<u>\$ 65</u>	<u>\$ 65</u>
Cash Paid During the Period for Income Taxes, Net of Refunds	<u>\$ 113</u>	<u>\$ 112</u>

*The Notes to Financial Statements are an integral part of this statement.*



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

**(1) Significant Accounting Policies**

**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 2017 Annual Report on Form 10-K. Certain reclassifications of prior year data have been made to conform with current year reporting.

**Operating Revenue**— Prior to 2018, the Company recognized revenue when persuasive evidence of an arrangement existed, product had shipped and the risks and rewards of ownership had transferred or services had been rendered, the price to the customer was fixed or determinable, and collectibility was reasonably assured, which generally occurred at the time of product shipment. Effective January 1, 2018, the Company adopted new revenue recognition guidance. Under this new guidance, operating revenue is recognized at the time a good or service is transferred to a customer and the customer obtains control of that good or receives the service performed. The Company’s sales arrangements with customers are predominantly short-term in nature involving a single performance obligation related to the delivery of products and generally provide for transfer of control at the time of shipment. In limited circumstances, arrangements may include service performed over time, or there may be significant obligations to the customer that are unfulfilled at the time of shipment, typically involving installation of equipment and customer acceptance. In these circumstances, operating revenue may be recognized over time as the service is provided to the customer or deferred until all significant obligations have been completed. The amount of operating revenue recorded reflects the consideration to which the Company expects to be entitled in exchange for goods or services and may include adjustments for customer allowances and rebates. Customer allowances and rebates consist primarily of volume discounts and other short-term incentive programs, which are estimated at the time of sale based on historical experience and anticipated trends. Shipping and handling charges billed to customers are included in revenue and are recognized along with the related product revenue as they are considered a fulfillment cost. Sales commissions are expensed when incurred, which is generally at the time of revenue recognition. Contract liabilities associated with sales arrangements primarily relate to deferred revenue on equipment sales and prepaid service contracts. Total deferred revenue was \$254 million and \$205 million as of March 31, 2018 and December 31, 2017, respectively, and is short-term in nature. For additional information regarding the Company’s operating revenue, see New Accounting Pronouncements below and Note 2. Operating Revenue.

**New Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued authoritative guidance to change the criteria for revenue recognition. The core principle of the new guidance is that revenue should be recognized to depict the transfer of control of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, expanded revenue disclosures are required. The Company’s sales arrangements with customers are predominantly short-term in nature and generally provide for transfer of control and risks and rewards of ownership at the time of product shipment or delivery of service. As such, the timing of revenue recognition under both the prior and new guidance is the same for the majority of the Company’s transactions. Effective January 1, 2018, the Company adopted the new revenue guidance under the modified retrospective method and recorded a cumulative-effect adjustment reducing retained earnings by \$9 million as of January 1, 2018. Under the modified retrospective method of adoption, prior periods are not restated and the new guidance is applied prospectively to revenue transactions completed on or after January 1, 2018. Given the nature of the Company’s revenue transactions, the new guidance had an immaterial impact on the Company’s operating revenue, results of operations, and financial position for the three months ended March 31, 2018. The Company updated its revenue recognition accounting policy to reflect the requirements of the new guidance and included additional disclosures regarding the Company’s revenue transactions. Refer to the Company’s operating revenue accounting policy above and Note 2. Operating Revenue for additional information.

In October 2016, the FASB issued authoritative guidance requiring the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs rather than when transferred to a third party as required under the prior guidance. The provisions of the new guidance will be applied prospectively to intra-entity asset transfers on or after January 1, 2018 and may result in future tax rate volatility. Upon adoption of the new guidance on January 1, 2018, the Company recorded a cumulative-effect adjustment reducing deferred tax assets and retained earnings by \$406 million. For the three months ended March 31, 2018, the impact of the new guidance on the Company’s effective income tax rate was not material.

In March 2017, the FASB issued authoritative guidance which changes the income statement presentation of net periodic benefit cost related to defined benefit pension and other postretirement plans. The primary change under the new guidance is that only the service cost component of net periodic benefit cost should be included in operating income and is eligible for capitalization as an asset. The other components of net periodic benefit cost ("other net periodic benefit cost"), including interest cost, expected return on assets, settlements, curtailments, and amortization of actuarial gains and losses and prior service cost, should be presented below operating income. Effective January 1, 2018, the Company adopted the new presentation of other net periodic benefit cost and restated the prior year statement of income and related disclosures for comparability, as required under the new guidance. For the three months ended March 31, 2018 and 2017, other net periodic benefit cost was income of \$5 million and \$2 million, respectively, and was presented in Other income (expense) in both periods. Refer to Note 5. Pension and Other Postretirement Benefits for additional information.

In February 2018, the FASB issued authoritative guidance which allows for an optional one-time reclassification of the stranded tax effects resulting from the change in the U.S. federal corporate income tax rate under the "Tax Cuts and Jobs Act" (the "Act") from accumulated other comprehensive income ("AOCI") to retained earnings. The guidance is effective January 1, 2019, with early adoption permitted. The Company elected to early adopt this guidance as of January 1, 2018 and to reclassify the stranded tax effects related to the Act, which resulted in an increase of \$45 million to both retained earnings and accumulated other comprehensive loss. Refer to Note 7. Accumulated Other Comprehensive Income (Loss) for additional information.

In February 2016, the FASB issued authoritative guidance to change the criteria for recognizing leasing transactions. Under the new guidance, a lessee will be required to recognize a lease liability and right-of-use lease asset for all leases with a lease term greater than twelve months, including operating leases, in the statement of financial position. Subsequent measurement, including presentation of expenses and cash flows, will depend on the classification of the lease as either a financing or operating lease. In addition, expanded disclosures will be required. This guidance is effective for the Company beginning January 1, 2019, with early adoption permitted. While the Company has not yet completed its evaluation of the impact the new lease accounting guidance will have on the consolidated financial statements and related disclosures, the Company expects to recognize right-of-use assets and liabilities for its operating leases in the statement of financial position upon adoption.

## (2) Operating Revenue

The Company's 85 diversified operating divisions are organized and managed based on similar product offerings and end markets, and are reported to senior management as the following seven segments: Automotive OEM; Food Equipment; Test & Measurement and Electronics; Welding; Polymers & Fluids; Construction Products; and Specialty Products. Operating revenue by product category, which is consistent with the Company's segment presentation, for the three months ended March 31, 2018 and 2017 was as follows:

In millions	Three Months Ended	
	March 31,	
	2018	2017
Automotive OEM	\$ 901	\$ 828
Food Equipment	527	497
Test & Measurement and Electronics	543	480
Welding	423	387
Polymers & Fluids	442	426
Construction Products	428	395
Specialty Products	485	463
Intersegment revenue	(5)	(5)
Total	\$ 3,744	\$ 3,471

Prior to 2018, the Company recognized revenue when persuasive evidence of an arrangement existed, product had shipped and the risks and rewards of ownership had transferred or services had been rendered, the price to the customer was fixed or determinable, and collectibility was reasonably assured, which generally occurred at the time of product shipment. Effective January 1, 2018, the Company adopted new revenue recognition guidance. Under this new guidance, operating revenue is recognized at the time a good or service is transferred to a customer and the customer obtains control of that good or receives the service performed. Given the nature of the Company's revenue transactions, the new guidance had an immaterial impact on the Company's operating revenue, results of operations, and financial position for the three months ended March 31, 2018. See Note 1. Significant Accounting Policies for additional information. The following is a description of the product offerings, end markets and typical revenue transactions for each 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.

Products sold in this segment are primarily manufactured to the customer's specifications and are sold under long-term supply agreements with OEM auto manufacturers and other top tier auto parts suppliers. The Company typically recognizes revenue for products in this segment at the time of shipment. Certain products may be produced utilizing tooling that is owned by the customer that the Company developed and is reimbursed by the customer for the associated cost. In these arrangements, the Company typically retains a contractual right to use the customer-owned tooling for the purpose of fulfilling its obligations under the supply agreement. The Company records reimbursements for the cost of customer-owned tooling as a cost offset rather than operating revenue as tooling is not considered a product offering central to the Company's operations.

**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 service, food institutional/restaurant 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.

Revenue for equipment sold in this segment is typically recognized at the time of product shipment. In limited circumstances involving installation of equipment and customer acceptance, the Company may recognize revenue upon completion of installation and acceptance by the customer. Annual service contracts are typically sold separate from equipment and the related revenue is recognized on a straight-line basis over the annual service period. Operating revenue for on-demand service repairs and parts is recorded upon completion and customer acceptance of the work performed.

**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.

Revenue for products sold in this segment is typically recognized at the time of shipment. In limited circumstances where significant obligations to the customer are unfulfilled at the time of shipment, typically involving installation of equipment and customer acceptance, revenue recognition is deferred until such obligations have been completed.

**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, construction, MRO, automotive original equipment manufacturers and tiers, 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.

Products in this segment are primarily manufactured to meet anticipated customer demand. The Company typically recognizes revenue for these products at the time of product shipment.

**Polymers & Fluids**— This segment is a highly branded supplier to niche markets that require value-added, differentiated products. Businesses in this segment produce engineered 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.

Products in this segment are primarily manufactured to meet anticipated customer demand. The Company typically recognizes revenue for these products at the time of product shipment.

**Construction Products**— This segment is a branded supplier of innovative engineered fastening systems and solutions. This segment primarily serves the residential construction, renovation/remodel 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.

Products in this segment are primarily manufactured to meet anticipated customer demand. The Company typically recognizes revenue for these products at the time of product shipment.

**Specialty Products**— This segment is focused on diversified niche market opportunities 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.

Products in this segment are primarily manufactured to meet anticipated customer demand. The Company typically recognizes revenue for these products at the time of product shipment. In limited circumstances where significant obligations to the customer are unfulfilled at the time of shipment, typically involving installation of equipment and customer acceptance, revenue is recognized when such obligations have been completed.

### (3) Income Taxes

The Company's effective tax rate for the three months ended March 31, 2018 and 2017 was 23.2% and 28.3%, respectively. The first quarter 2018 effective tax rate was lower primarily as a result of the lower U.S. corporate federal tax rate and a discrete income tax benefit of \$14 million related to

foreign tax credits. Additionally, the effective tax rate for both respective periods included discrete income tax benefits of \$6 million and \$12 million in 2018 and 2017, respectively, related to excess tax benefits from stock-based compensation.

On December 22, 2017, the "Tax Cuts and Jobs Act" (the "Act") was enacted in the United States. The provisions of the Act significantly revised the U.S. corporate income tax rules. At December 31, 2017, the Company had not completed the accounting for the tax effects of enactment of the Act; however, the Company made a reasonable estimate of the effects on the existing deferred tax balances and one-time transition tax. The Company continues to analyze certain aspects of the Act and may refine its calculations, which could potentially affect the measurement of the amounts recorded at December 31, 2017. The provisional amounts recorded for the year ended December 31, 2017, and unchanged at March 31, 2018, reflect the Company's best estimate based on information currently available and are subject to future changes due to subsequent clarification of the tax law and refinement of estimated amounts.

The Company and its subsidiaries file 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. Due to the ongoing audits, 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 \$33 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 proceeded to court with the trial taking place in the third quarter of 2016. Final decision by the tax court is expected in 2018. Although the court's final decision cannot be predicted with certainty, the Company believes its position continues to be supportable. Accordingly, no reserve has been recorded related to this matter.

#### (4) Inventories

Inventories as of March 31, 2018 and December 31, 2017 were as follows:

In millions	March 31, 2018	December 31, 2017
Raw material	\$ 491	\$ 465
Work-in-process	190	141
Finished goods	743	703
LIFO reserve	(89)	(89)
Total inventories	<u>\$ 1,335</u>	<u>\$ 1,220</u>

## (5) Pension and Other Postretirement Benefits

Pension and other postretirement benefit costs for the three months ended March 31, 2018 and 2017 were as follows:

In millions	Three Months Ended March 31,			
	Pension		Other Postretirement Benefits	
	2018	2017	2018	2017
Components of net periodic benefit cost:				
Service cost	\$ 15	\$ 16	\$ 2	\$ 2
Interest cost	18	18	5	5
Expected return on plan assets	(32)	(33)	(6)	(6)
Amortization of actuarial loss (gain)	11	14	(1)	—
Total net periodic benefit cost	<u>\$ 12</u>	<u>\$ 15</u>	<u>\$ —</u>	<u>\$ 1</u>

The service cost component of net periodic benefit cost is presented within Cost of revenue and Selling, administrative, and research and development expenses in the statement of income while the other components of net periodic benefit cost are presented within Other income (expense).

The Company expects to contribute approximately \$26 million to its pension plans and \$5 million to its other postretirement benefit plans in 2018. As of March 31, 2018, contributions of \$12 million to pension plans and \$2 million to other postretirement benefit plans have been made.

## (6) Debt

Short-term debt included commercial paper of \$10 million and \$849 million as of March 31, 2018 and December 31, 2017, respectively. In addition, in the first quarter of 2018, the Company reclassified \$649 million related to the 1.95% notes due March 1, 2019 from Long-term debt to Short-term debt.

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 March 31, 2018 and December 31, 2017 were as follows:

In millions	March 31, 2018		December 31, 2017	
Fair value	\$	7,945	\$	8,052
Carrying value		7,539		7,479

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

## (7) Accumulated Other Comprehensive Income (Loss)

The following table summarizes changes in Accumulated other comprehensive income (loss) for the three months ended March 31, 2018 and 2017:

In millions	Three Months Ended March 31,	
	2018	2017
Beginning balance	\$ (1,287)	\$ (1,807)
Adoption of new accounting guidance related to reclassification of certain tax effects	(45)	—
Foreign currency translation adjustments during the period	69	144
Income taxes	14	10
Total foreign currency translation adjustments, net of tax	83	154
Pension and other postretirement benefit adjustments during the period	1	—
Pension and other postretirement benefit adjustments reclassified to income	10	14
Income taxes	(2)	(4)
Total pension and other postretirement benefit adjustments, net of tax	9	10
Ending balance	\$ (1,240)	\$ (1,643)

Effective January 1, 2018, the Company elected to early adopt new accounting guidance related to the stranded tax effects resulting from the change in the U.S. federal corporate income tax rate under the "Tax Cuts and Jobs Act" (the "Act") and reclassified \$45 million of stranded income tax effects from Accumulated other comprehensive income (loss) to Retained earnings. Refer to Note 1. Significant Accounting Policies for additional information.

Pension and other postretirement benefit adjustments reclassified to income relate primarily to the amortization of actuarial losses. Refer to Note 5. Pension and Other Postretirement Benefits 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 2015 and 2014 Euro notes were \$1.2 billion and \$1.2 billion, respectively, as of March 31, 2018. 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 (loss). The unrealized pre-tax gain recorded in Accumulated other comprehensive income (loss) related to the net investment hedge was \$22 million and \$81 million as of March 31, 2018 and December 31, 2017, respectively.

The ending balance of Accumulated other comprehensive income (loss) as of March 31, 2018 and 2017 consisted of cumulative translation adjustment losses, net of tax, of \$902 million and \$1.2 billion, respectively, and unrecognized pension and other postretirement benefits costs, net of tax, of \$338 million and \$395 million, respectively.

## (8) Segment Information

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

Illinois Tool Works Inc. (the "Company" or "ITW") is a global manufacturer of a diversified range of industrial products and equipment with 85 divisions in 55 countries. As of December 31, 2017, the Company employed approximately 50,000 people.

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

Due to the large number of diverse businesses and the Company's decentralized operating structure, the Company does not require its businesses to provide detailed information on operating results. Instead, the Company's corporate management collects data on several key measurements: operating revenue, operating income, operating margin, overhead costs, number of months on hand in inventory, days sales outstanding in accounts receivable, past due receivables and return on invested capital. These key measures are monitored by management and significant changes in operating results versus current trends in end markets and variances from forecasts are discussed with operating unit management.

### 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 front to back process** is the operating system that is applied in every ITW business. Initially introduced as a manufacturing efficiency tool in the 1980s, ITW has continually refined, improved and expanded 80/20 into a proprietary, holistic business management process that generates significant value for the Company and its customers. Through the application of data-driven insights generated by 80/20 practice, ITW focuses on its largest and best opportunities (the "80") and eliminates cost, complexity and distractions associated with the less profitable opportunities (the "20"). 80/20 enables ITW businesses to consistently achieve world-class operational excellence in 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 insight gathered from the 80/20 front to back 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 subsequently 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 17,000 granted and pending patents;
- ITW's **decentralized, entrepreneurial culture** enables 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 specific customers' needs. ITW colleagues recognize their unique responsibilities to execute the Company's strategy and values. As a result, the Company maintains a focused and simple organizational structure that, combined with outstanding execution, delivers best-in-class services adapted to each business' customers and end markets.

### ENTERPRISE STRATEGY

In late 2012, ITW began the first phase of its strategic framework, transitioning the Company on 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 five years.

The roots of ITW's Enterprise Strategy began in late 2011 / early 2012, when the Company undertook a complete review of its performance. Focusing on its businesses delivering consistent above-market growth with best-in-class margins and returns, ITW developed a strategy to replicate that performance across its operations.

Based on this rigorous evaluation, ITW determined that solid and consistent above-market organic growth must be the core growth engine to deliver world-class financial performance and compelling long-term returns for its shareholders. To shift its primary growth engine to organic, the Company began executing a multi-step approach.

- The first step was to narrow the focus and improve the quality of ITW's business portfolio. As part of the **Portfolio Management** initiative, 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 operating margins and generate price/cost increases. The Company achieved this through product line simplification, or eliminating the complexity and overhead costs associated with smaller product lines and customers, while supporting and growing the businesses' largest / most profitable customers and product lines. With the initiative nearly complete and ITW businesses demonstrating notably improved financial performance, the Company believes that the product line simplification work is returning to more normalized levels.

- Step two, **Business Structure Simplification**, was implemented to simplify and scale-up ITW's operating structure to support increased engineering, marketing, and sales resources, and, at the same time, improve global reach and competitiveness, all of which were critical to driving accelerated organic growth. ITW now has 85 scaled-up divisions with significantly enhanced focus on growth investments, core customers and products, and customer-back innovation.
- The **Strategic Sourcing** initiative established sourcing as a core strategic and operational capability at ITW. The Company's 80/20-enabled sourcing organization has delivered an average of one percent reduction in spend each year from 2013 through 2017 and is on track to do the same in 2018.
- With the portfolio realignment and scale-up work largely complete, the Company **shifted its focus to preparing for and accelerating, organic growth**, reapplying 80/20 to optimize its newly scaled-up divisions for growth, first, to build a foundation of operational excellence, and second, to identify the best opportunities to drive organic growth.

ITW has clearly demonstrated superior 80/20 management, resulting in meaningful incremental improvement in margins and returns as evidenced by the Company's operating margin and after-tax return on invested capital. At the same time, these 80/20 initiatives can also result in restructuring initiatives that reduce costs and improve profitability and returns. With this first phase of the strategy nearing completion, the Company will look ahead to the next five years and delivering differentiated performance on a sustained basis.

## SUSTAINED DIFFERENTIATED PERFORMANCE

While the Company has made considerable progress and ITW's performance is nearing best-in-class levels, the Company has significant opportunity for further improvement. The second phase of the strategic framework is focused on delivering differentiated performance on a sustained basis, with consistent above market organic growth. Moving forward, the Company remains committed to the four strategic principles that have served as the foundation of its progress over the past five years and that the Company believes best positions ITW to deliver continued differentiated performance over the next five years:

- The ITW Business Model is the Company's competitive advantage
- Focus on quality growth
- "Do what we say" execution is a critical differentiator
- Invest only where ITW has a competitive advantage

### The ITW Business Model is the Company's Competitive Advantage

The ITW Business Model is the combination of a set of strategic, operational, and cultural approaches and practices that is applied to every ITW business. The Business Model has existed inside the Company for over 30 years and is truly ITW's differentiating competitive advantage. The ITW Business Model is comprised of three elements:

- 80/20 Front to Back Process = How the Company Operates
- Customer-Back Innovation Approach = How the Company Innovates
- Decentralized Entrepreneurial Culture = How the Company Executes

## Focus on Quality Growth

ITW prioritizes **high-quality revenue growth** and, as such, the Company's primary growth focus is organic.

Leveraging the Business Model and the 80/20 front to back process provides a clear view of where to focus for high-quality growth. The Company targets differentiated end-markets and customers with critical needs and challenging pain points. ITW generates high-quality growth through consistent customer-back innovation and customer service excellence.

The Company only invests and operates in industries and businesses that have the right "raw material" to generate high quality organic growth through the application of the ITW Business Model. ITW's current portfolio of seven segments offers solid growth potential and a high degree of diversification in terms of geographic and end market exposures, enabling the Company to deliver consistent high-quality growth in an increasingly volatile and competitive global market environment.

### "Do What We Say" Execution is a Critical Differentiator

ITW's commitment to execution is a key differentiator for ITW. Living up to the Company's commitments - "do what we say" execution - is a deeply embedded core element of the culture. The culture is the engine that translates ITW's strategy into action, and action into results.

All divisions function within a "framework" that defines how the culture operates and defines the Company's values, business model and strategy to ensure all divisions are working toward our common set of goals. Business leaders have the flexibility to define the actions and customize their approach to meet those goals. This "flexibility within the framework" establishes an entrepreneurial environment where decisions are made "bottom up" by those with the greatest knowledge, capability and proximity to the customer, which enables our businesses to be nimble and react quickly to market conditions and customer requirements.

ITW is simple, straightforward and transparent in everything it does. The Company sets clear performance expectations and financial targets, executes against these at the appropriate pace, and establishes the freedom to define how to achieve results within the construct of the Business Model.

### Invest Only Where ITW Has a Competitive Advantage

The Company is highly focused and disciplined in its approach to invest only where it can leverage the ITW Business Model into compelling and sustainable competitive advantage.

Investments to support organic growth and sustain its highly differentiated core businesses, such as new product innovation, marketing programs, simplification projects, and capital investments, are ITW's number one investment priority.

## 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.
- **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.
- **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 is expected to result 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 following 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 2017 Annual Report on Form 10-K.

## CONSOLIDATED RESULTS OF OPERATIONS

The Company's strong first quarter financial performance reflected continued focus on leveraging the business portfolio and the highly differentiated Business Model to its full potential. All segments achieved worldwide organic revenue growth and had operating margin above 20% in the first quarter of 2018.

The Company's consolidated results of operations for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended			Components of Increase (Decrease)				
	March 31,		Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Currency	Total
2018	2017							
Operating revenue	\$ 3,744	\$ 3,471	7.9%	2.6%	—%	—%	5.3%	7.9%
Operating income	\$ 903	\$ 807	11.9%	5.3%	—%	1.0%	5.6%	11.9%
Operating margin %	24.1%	23.2%	90 bps	60 bps	—	30 bps	—	90 bps

- Operating revenue grew in the first quarter due the favorable effect of foreign currency translation and an increase in organic revenue.
- Organic revenue increased 2.6% as all segments had worldwide organic revenue growth primarily due to penetration gains, higher end market demand and product innovation.
  - North American organic revenue increased 3.2% as growth in five segments was partially offset by a decline in the Specialty Products and Polymers & Fluids segments.
  - Asia Pacific organic revenue increased 3.3% as growth in six segments was partially offset by a decline in the Specialty Products segment.
  - Europe, Middle East and Africa organic revenue increased 1.1% as growth in the Test & Measurement and Electronics, Specialty Products and Automotive OEM segments was partially offset by a decline in the Construction Products, Food Equipment, Welding and Polymers & Fluids segments.
- Operating income of \$903 million increased 11.9% as compared to the prior year. Operating margin of 24.1% increased 90 basis points primarily driven by the benefits of the Company's enterprise initiatives of 110 basis points and lower restructuring expenses, partially offset by unfavorable price/cost of 50 basis points.
- The effective tax rate for the first quarter of 2018 was 23.2% compared to 28.3% in 2017. The first quarter 2018 effective tax rate was lower primarily as a result of the lower U.S. corporate federal tax rate and a discrete income tax benefit of \$14 million related to foreign tax credits. Additionally, the effective tax rate for both respective periods included discrete income tax benefits of \$6 million and \$12 million in 2018 and 2017, respectively, related to excess tax benefits from stock-based compensation. Excluding these discrete tax benefits, the Company's effective tax rate for the first quarter of 2018 and 2017 would have been 25.5% and 30.0%, respectively. The estimated effective tax rate for the full year of 2018 is approximately 25%. Refer to Note 3. Income Taxes in Item 1 - Financial Statements for further information.
- Diluted earnings per share (EPS) of \$1.90 increased 23.4% in 2018.
- Free cash flow was \$444 million in the first quarter of 2018, an increase of 11.3%. Refer to the Cash Flow section of Liquidity and Capital Resources for a reconciliation of this non-GAAP measure.
- The Company repurchased approximately 3.0 million shares of its common stock in the first quarter of 2018 for approximately \$500 million.
- Total cash dividends of \$266 million were paid in the first quarter of 2018.
- After-tax return on average invested capital in the first quarter of 2018 was 27.7%, an increase of 400 basis points, of which 350 basis points related to the new U.S. tax rules and regulations. Refer to the After-Tax Return on Average Invested Capital section of Liquidity and Capital Resources for a reconciliation of this non-GAAP measure.

## RESULTS OF OPERATIONS BY SEGMENT

Total operating revenue and operating income for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended March 31,			
	Operating Revenue		Operating Income	
	2018	2017	2018	2017
Automotive OEM	\$ 901	\$ 828	\$ 217	\$ 202
Food Equipment	527	497	130	125
Test & Measurement and Electronics	543	480	127	96
Welding	423	387	117	107
Polymers & Fluids	442	426	92	88
Construction Products	428	395	95	89
Specialty Products	485	463	130	124
Intersegment revenue	(5)	(5)	—	—
Unallocated	—	—	(5)	(24)
Total	\$ 3,744	\$ 3,471	\$ 903	\$ 807

Segments are allocated a fixed overhead charge based on the segment's revenue. Expenses not charged to the segments are reported separately as Unallocated. Because the Unallocated category includes a variety of items, it is subject to fluctuations on a quarterly and annual basis.

### 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.

The results of operations for the Automotive OEM segment for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended			Components of Increase (Decrease)				
	March 31,			Organic	Acquisition/Divestiture	Restructuring	Foreign Currency	Total
	2018	2017	Inc (Dec)					
Operating revenue	\$ 901	\$ 828	8.8%	1.0 %	—%	—%	7.8%	8.8%
Operating income	\$ 217	\$ 202	7.6%	(1.6)%	—%	1.5%	7.7%	7.6%
Operating margin %	24.1%	24.4%	(30) bps	(70) bps	—	40 bps	—	(30) bps

- Operating revenue increased due to the favorable effect of foreign currency translation and higher organic revenue.
- Organic revenue grew 1.0% as a result of penetration gains, exceeding worldwide auto builds which declined 1%.
  - European organic revenue grew 1.1%, exceeding European auto builds which were flat.
  - Asia Pacific organic revenue increased 0.6%. China organic revenue grew 7.8% versus Chinese auto builds which declined 3%. Auto builds of foreign automotive manufacturers in China, where the Company has higher content, grew 1% in the first quarter.
  - North American organic revenue increased 1.1% versus North American auto builds which declined 3%. Auto build growth for the Detroit 3, where the Company has higher content, was flat in the first quarter.
- Operating margin was 24.1%. The decrease of 30 basis points was primarily driven by unfavorable price/cost of 120 basis points, partially offset by the net benefits of the Company's enterprise initiatives and cost management and lower restructuring expenses of 40 basis points.

## 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 service, food institutional/restaurant 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.

The results of operations for the Food Equipment segment for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended			Components of Increase (Decrease)				
	March 31,		Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Currency	Total
2018	2017							
Operating revenue	\$ 527	\$ 497	6.0%	0.4 %	—%	—%	5.6%	6.0%
Operating income	\$ 130	\$ 125	3.9%	(2.5)%	—%	1.2%	5.2%	3.9%
Operating margin %	24.6%	25.1%	(50) bps	(70) bps	—	30 bps	(10) bps	(50) bps

- Operating revenue increased due to the favorable effect of foreign currency translation and higher organic revenue.
- Organic revenue increased 0.4% as equipment and service organic revenue increased 0.4% and 0.6%, respectively.
  - North American organic revenue increased 0.2%. Equipment organic revenue was flat as higher end market demand in food service, refrigeration and cooking was offset by lower end market demand in food retail. Service organic revenue grew 0.6%.
  - International organic revenue increased 0.7%. Equipment organic revenue grew 0.9% primarily due to higher demand in the European warewash end markets, partially offset by lower end market demand in refrigeration. Service organic revenue increased 0.6%.
- Operating margin of 24.6% declined 50 basis points primarily due to the unfavorable impact of product mix and higher employee-related expenses, partially offset by benefits from the Company's enterprise initiatives, lower restructuring expenses and favorable price/cost of 10 basis points.

## 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.

The results of operations for the Test & Measurement and Electronics segment for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended			Components of Increase (Decrease)					
	March 31,								
	2018	2017	Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Currency	Total	
Operating revenue	\$ 543	\$ 480	13.1%	7.6%	—%	—%	5.5%	13.1%	
Operating income	\$ 127	\$ 96	32.1%	23.8%	—%	2.0%	6.3%	32.1%	
Operating margin %	23.4%	20.0%	340 bps	310 bps	—	30 bps	—	340 bps	

- Operating revenue increased due to higher organic revenue and the favorable effect of foreign currency translation.
- Organic revenue increased 7.6%.
  - Organic revenue for the test and measurement businesses increased 9.4% primarily due to higher semi-conductor end market demand in North America. Instron, where demand is more closely tied to the capital spending environment, had organic revenue growth of 14.7%.
  - Electronics organic revenue grew 5.3%. The electronics assembly businesses increased 2.3% primarily due to higher demand in the Asia Pacific solar end market. The other electronics businesses grew 7.2% due to higher semi-conductor end market demand across all major regions.
- Operating margin was 23.4%. The increase of 340 basis points was primarily due to positive operating leverage of 210 basis points, the net benefits of the Company's enterprise initiatives and cost management, lower restructuring expenses and favorable price/cost of 10 basis points.

## 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, construction, MRO, automotive original equipment manufacturers and tiers, 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.

The results of operations for the Welding segment for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended			Components of Increase (Decrease)					
	March 31,								
	2018	2017	Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Currency	Total	
Operating revenue	\$ 423	\$ 387	9.4%	7.6%	—%	—%	1.8%	9.4%	
Operating income	\$ 117	\$ 107	9.6%	8.1%	—%	0.7%	0.8%	9.6%	
Operating margin %	27.7%	27.7%	—%	10 bps	—	20 bps	(30) bps	—	

- Operating revenue increased due to higher organic revenue and the favorable effect of foreign currency translation.
- Organic revenue grew 7.6% driven by growth in equipment of 10.5% and consumables of 3.6%. Organic revenue grew due to increased demand in the industrial end markets related to heavy equipment for agriculture, infrastructure and mining and in the commercial end markets related to construction, light fabrication and farm and ranch customers.
  - North American organic revenue increased 9.4% primarily due to growth in the industrial and commercial end markets of 15.0% and 1.6%, respectively.
  - International organic revenue decreased 0.4% primarily due to weaker end market demand in the European oil and gas end markets.

- Operating margin of 27.7% was flat compared to the prior year. The benefits from the Company's enterprise initiatives and lower restructuring expenses were offset by higher operating expenses, including freight and employee-related expenses.

## POLYMERS & FLUIDS

This segment is a highly branded supplier to niche markets that require value-added, differentiated products. Businesses in this segment produce engineered 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.

The results of operations for the Polymers & Fluids segment for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended			Components of Increase (Decrease)					
	March 31,								
	2018	2017	Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Currency	Total	
Operating revenue	\$ 442	\$ 426	3.8%	0.3 %	—%	—%	3.5%	3.8%	
Operating income	\$ 92	\$ 88	5.1%	(0.7)%	—%	1.9%	3.9%	5.1%	
Operating margin %	20.9%	20.6%	30 bps	(20) bps	—	40 bps	10 bps	30 bps	

- Operating revenue increased due to the favorable effect of foreign currency translation and higher organic revenue.
- Organic revenue increased 0.3% as higher demand in Asia and South America was partially offset by lower demand in North America and Europe.
  - Organic revenue for the fluids businesses grew 1.1% primarily due to an increase in the industrial maintenance, repair, and operations end markets across all major regions.
  - Organic revenue for the polymers businesses increased 0.8% primarily driven by an increase in North America and Asia Pacific, partially offset by a decline in Europe.
  - Organic revenue for the automotive aftermarket businesses decreased 0.4% primarily driven by a decline in the car care, engine and body repair businesses in North America, partially offset by an increase in the tire repair businesses in North America and the additives businesses in Europe.
- Operating margin of 20.9% increased 30 basis points primarily driven by the net benefits of the Company's enterprise initiatives and cost management and lower restructuring expenses, partially offset by unfavorable price/cost of 100 basis points, product mix and higher freight costs.

## CONSTRUCTION PRODUCTS

This segment is a branded supplier of innovative engineered fastening systems and solutions. This segment primarily serves the residential construction, renovation/remodel 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.

The results of operations for the Construction Products segment for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended			Components of Increase (Decrease)					
	March 31,								
	2018	2017	Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Currency	Total	
Operating revenue	\$ 428	\$ 395	8.3%	2.9%	—%	—%	5.4%	8.3%	
Operating income	\$ 95	\$ 89	6.7%	2.0%	—%	(0.6)%	5.3%	6.7%	
Operating margin %	22.2%	22.5%	(30) bps	(20) bps	—	(10) bps	—	(30) bps	

- Operating revenue increased due to the favorable effect of foreign currency translation and higher organic revenue.
- Organic revenue increased 2.9%.
  - North American organic revenue grew 6.6% primarily due to 8.7% growth in the residential end markets, partially offset by a decline of 1.8% in the commercial end markets.
  - International organic revenue increased 0.4%. Asia Pacific organic revenue increased 3.2% primarily due to growth in the Australia and New Zealand retail end markets. European organic revenue decreased 2.3% primarily due to a decline in the United Kingdom and the Nordic countries.
- Operating margin was 22.2%. The decline of 30 basis points was primarily driven by unfavorable price/cost of 70 basis points and higher freight and employee-related expenses, partially offset by benefits from the Company's enterprise initiatives.

## SPECIALTY PRODUCTS

This segment is focused on diversified niche market opportunities 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 results of operations for the Specialty Products segment for the first quarter of 2018 and 2017 were as follows:

Dollars in millions	Three Months Ended			Components of Increase (Decrease)					
	March 31,								
	2018	2017	Inc (Dec)	Organic	Acquisition/Divestiture	Restructuring	Foreign Currency	Total	
Operating revenue	\$ 485	\$ 463	4.9%	0.5%	(0.3)%	—%	4.7%	4.9%	
Operating income	\$ 130	\$ 124	4.2%	(0.7)%	(0.3)%	0.5%	4.7%	4.2%	
Operating margin %	26.7%	26.9%	(20) bps	(30) bps	—	10 bps	—	(20) bps	

- Operating revenue increased primarily due to the favorable effect of foreign currency translation and higher organic revenue.
- Organic revenue increased 0.5% as equipment sales increased 7.7%, partially offset by a decline in consumable sales of 1.1%.
  - International organic revenue increased 2.3% primarily driven by growth in the consumer packaging and equipment businesses in Europe.
  - North American organic revenue decreased 0.5% primarily due to a decline in the labels businesses, partially offset by an increase in the equipment businesses.

- Operating margin was 26.7%. The decrease of 20 basis points was primarily driven by higher operating expenses, including employee-related expenses, and unfavorable price/cost of 20 basis points, partially offset by benefits from the Company's enterprise initiatives.

#### **OTHER FINANCIAL HIGHLIGHTS**

- Interest expense was \$66 million in the first quarter of 2018, an increase of \$2 million primarily due to higher outstanding commercial paper during the first quarter of 2018.
- Other income (expense) was income of \$12 million in the first quarter of 2018, an increase of \$6 million primarily driven by other net periodic benefit income related to defined benefit pension and other postretirement plans and lower translation losses.

#### **NEW ACCOUNTING PRONOUNCEMENTS**

In May 2014, the Financial Accounting Standards Board (the "FASB") issued authoritative guidance to change the criteria for revenue recognition. The core principle of the new guidance is that revenue should be recognized to depict the transfer of control of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, expanded revenue disclosures are required. The Company's sales arrangements with customers are predominantly short-term in nature and generally provide for transfer of control and risks and rewards of ownership at the time of product shipment or delivery of service. As such, the timing of revenue recognition under both the prior and new guidance is the same for the majority of the Company's transactions. Effective January 1, 2018, the Company adopted the new revenue guidance under the modified retrospective method and recorded a cumulative-effect adjustment reducing retained earnings by \$9 million as of January 1, 2018. Under the modified retrospective method of adoption, prior periods are not restated and the new guidance is applied prospectively to revenue transactions completed on or after January 1, 2018. Given the nature of the Company's revenue transactions, the new guidance had an immaterial impact on the Company's operating revenue, results of operations, and financial position for the three months ended March 31, 2018. The Company updated its revenue recognition accounting policy to reflect the requirements of the new guidance and included additional disclosures regarding the Company's revenue transactions. Refer to Note 1. Significant Accounting Policies and Note 2. Operating Revenue in Item 1. Financial Statements for additional information.

In October 2016, the FASB issued authoritative guidance requiring the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs rather than when transferred to a third party as required under the prior guidance. The provisions of the new guidance will be applied prospectively to intra-entity asset transfers on or after January 1, 2018 and may result in future tax rate volatility. Upon adoption of the new guidance on January 1, 2018, the Company recorded a cumulative-effect adjustment reducing deferred tax assets and retained earnings by \$406 million. For the three months ended March 31, 2018, the impact of the new guidance on the Company's effective income tax rate was not material.

In March 2017, the FASB issued authoritative guidance which changes the income statement presentation of net periodic benefit cost related to defined benefit pension and other postretirement plans. The primary change under the new guidance is that only the service cost component of net periodic benefit cost should be included in operating income and is eligible for capitalization as an asset. The other components of net periodic benefit cost ("other net periodic benefit cost"), including interest cost, expected return on assets, settlements, curtailments, and amortization of actuarial gains and losses and prior service cost, should be presented below operating income. Effective January 1, 2018, the Company adopted the new presentation of other net periodic benefit cost and restated the prior year statement of income and related disclosures for comparability, as required under the new guidance. For the three months ended March 31, 2018 and 2017, other net periodic benefit cost was income of \$5 million and \$2 million, respectively, and was presented in Other income (expense) in both periods. Refer to Note 5. Pension and Other Postretirement Benefits in Item 1. Financial Statements for additional information.

In February 2018, the FASB issued authoritative guidance which allows for an optional one-time reclassification of the stranded tax effects resulting from the change in the U.S. federal corporate income tax rate under the "Tax Cuts and Jobs Act" (the "Act") from accumulated other comprehensive income ("AOCI") to retained earnings. The guidance is effective January 1, 2019, with early adoption permitted. The Company elected to early adopt this guidance as of January 1, 2018 and to reclassify the stranded tax effects related to the Act, which resulted in an increase of \$45 million to both retained earnings and accumulated other comprehensive loss. Refer to Note 7. Accumulated Other Comprehensive Income (Loss) in Item 1. Financial Statements for additional information.

In February 2016, the FASB issued authoritative guidance to change the criteria for recognizing leasing transactions. Under the new guidance, a lessee will be required to recognize a lease liability and right-of-use lease asset for all leases with a lease term

greater than twelve months, including operating leases, in the statement of financial position. Subsequent measurement, including presentation of expenses and cash flows, will depend on the classification of the lease as either a financing or operating lease. In addition, expanded disclosures will be required. This guidance is effective for the Company beginning January 1, 2019, with early adoption permitted. While the Company has not yet completed its evaluation of the impact the new lease accounting guidance will have on the consolidated financial statements and related disclosures, the Company expects to recognize right-of-use assets and liabilities for its operating leases in the statement of financial position upon adoption.

## LIQUIDITY AND CAPITAL RESOURCES

The Company's primary sources of liquidity are free cash flow and short-term credit facilities. In addition, the Company had \$1.9 billion of cash and equivalents on hand at March 31, 2018 and also maintains strong access to public debt markets. Management believes that these sources are sufficient to service debt and to finance the Company's capital allocation priorities, which include:

- internal investments to support organic growth and sustain core businesses;
- payment of an attractive dividend to shareholders; and
- external investments in selective strategic acquisitions that support the Company's organic growth focus, and an active share repurchase program.

The Company believes that, based on its revenue, operating margin, current free cash flow, and credit ratings, it could readily obtain additional financing if necessary.

### Cash Flow

The Company uses free cash flow to measure cash flow generated by operations that is available for dividends, share repurchases, acquisitions and debt repayment. The Company believes this non-GAAP financial measure is useful to investors in evaluating the Company's financial performance and measures the Company's ability to generate cash internally to fund Company initiatives. Free cash flow represents net cash provided by operating activities less additions to plant and equipment. Free cash flow is a measurement that is not the same as net cash flow from operating activities per the statement of cash flows and may not be consistent with similarly titled measures used by other companies. Summarized cash flow information for the first quarter of 2018 and 2017 was as follows:

<b>In millions</b>	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
Net cash provided by operating activities	\$ 538	\$ 463
Additions to plant and equipment	(94)	(64)
Free cash flow	<u>\$ 444</u>	<u>\$ 399</u>
Cash dividends paid	\$ (266)	\$ (226)
Repurchases of common stock	(500)	(250)
Acquisition of businesses (excluding cash and equivalents) and additional interest in affiliates	—	(3)
Net proceeds from (repayments of) debt with original maturities of three months or less	(840)	671
Repayments of debt with original maturities of more than three months	—	(652)
Other	3	17
Effect of exchange rate changes on cash and equivalents	5	65
Net increase (decrease) in cash and equivalents	<u>\$ (1,154)</u>	<u>\$ 21</u>

### ***Stock Repurchase Program***

On February 13, 2015, the Company's Board of Directors authorized a stock repurchase program which provides for the buyback of up to \$6.0 billion of the Company's common stock over an open-ended period of time (the "2015 Program"). Under the 2015 Program, the Company repurchased approximately 1.9 million shares of its common stock at an average price of \$128.47 in the first quarter of 2017, approximately 1.8 million shares of its common stock at an average price of \$136.81 in the second quarter of 2017, approximately 1.8 million shares of its common stock at an average price of \$142.54 in the third quarter of 2017, approximately 1.6 million shares of its common stock at an average price of \$157.51 in the fourth quarter of 2017, and approximately 3.0 million shares of its common stock at an average price of \$164.04 in the first quarter of 2018. As of March 31, 2018, there were approximately \$1.9 billion of authorized repurchases remaining under the 2015 Program.

### ***After-Tax Return on Average Invested Capital***

The Company uses after-tax return on average invested capital ("ROIC") to measure the effectiveness of its operations' use of invested capital to generate profits. ROIC is a non-GAAP financial measure that the Company believes is a meaningful metric to investors in evaluating the Company's financial performance and may be different than the method used by other companies to calculate ROIC. Average invested capital represents the net assets of the Company, excluding cash and equivalents and outstanding debt, which are excluded as they do not represent capital investment in the Company's operations. Average invested capital is calculated using balances at the start of the period and at the end of each quarter. ROIC for the first quarter of 2018 and 2017 was as follows:

<b>Dollars in millions</b>	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Operating income	\$ 903	\$ 807
Tax rate <sup>(1)</sup>	25.0%	28.3%
Income taxes	(226)	(229)
Operating income after taxes	\$ 677	\$ 578
Invested capital:		
Trade receivables	\$ 2,874	\$ 2,534
Inventories	1,335	1,158
Net plant and equipment	1,829	1,674
Goodwill and intangible assets	6,021	6,016
Accounts payable and accrued expenses	(1,905)	(1,723)
Other, net	(382)	222
Total invested capital	\$ 9,772	\$ 9,881
Average invested capital	\$ 9,797	\$ 9,748
Annualized return on average invested capital	27.7%	23.7%

<sup>(1)</sup> The tax rate for the three months ended March 31, 2018 represents the estimated effective tax rate for the full year of 2018.

ROIC for the three months ended March 31, 2018 was 27.7 percent, an improvement of 400 basis points, of which 350 basis points related to the new U.S. tax rules and regulations.

## Working Capital

Management uses working capital as a measurement of the short-term liquidity of the Company. Net working capital as of March 31, 2018 and December 31, 2017 is summarized as follows:

In millions	March 31, 2018	December 31, 2017	Increase/ (Decrease)
<b>Current assets:</b>			
Cash and equivalents	\$ 1,940	\$ 3,094	\$ (1,154)
Trade receivables	2,874	2,628	246
Inventories	1,335	1,220	115
Other	274	336	(62)
Total current assets	6,423	7,278	(855)
<b>Current liabilities:</b>			
Short-term debt	660	850	(190)
Accounts payable and accrued expenses	1,905	1,848	57
Other	360	355	5
Total current liabilities	2,925	3,053	(128)
Net working capital	\$ 3,498	\$ 4,225	\$ (727)

Cash and equivalents totaled approximately \$1.9 billion as of March 31, 2018 and \$3.1 billion as of December 31, 2017, primarily all of which was held by international subsidiaries. Cash and equivalents held internationally may be subject to foreign withholding taxes if repatriated to the U.S. A portion of the cash and equivalents balances held internationally is typically used for international operating needs, reinvested to fund expansion of existing international businesses, used to fund new international acquisitions, or used to repay debt held internationally. In the U.S., the Company utilizes cash flows from domestic operations to fund domestic cash needs, which primarily consist of dividend payments, share repurchases, acquisitions, servicing of domestic debt obligations and general corporate needs. The Company also uses its commercial paper program, which is backed by long-term credit facilities, for short-term liquidity needs. The Company believes cash generated domestically and liquidity provided by the Company's commercial paper program will continue to be sufficient to fund cash requirements in the U.S.

On December 22, 2017, the "Tax Cuts and Jobs Act" (the "Act") was enacted in the United States. The provisions of the Act significantly revised the U.S. corporate income tax rules, including a one-time repatriation tax on the deemed repatriation of post-1986 undistributed earnings of foreign subsidiaries. As a result of the one-time repatriation provisions of the Act, the Company provided for substantially all U.S. taxes on the undistributed earnings of its foreign subsidiaries as of December 31, 2017. In the first quarter of 2018, the Company repatriated approximately \$1.5 billion of cash and equivalents held by its international subsidiaries, which was primarily used to repay outstanding commercial paper and to fund share repurchases in the quarter.

## Debt

Total debt as of March 31, 2018 and December 31, 2017 was as follows:

In millions	March 31, 2018	December 31, 2017
Short-term debt	\$ 660	\$ 850
Long-term debt	6,889	7,478
Total debt	\$ 7,549	\$ 8,328

Short-term debt included commercial paper of \$10 million and \$849 million as of March 31, 2018 and December 31, 2017, respectively. In addition, in the first quarter of 2018, the Company reclassified \$649 million related to the 1.95% notes due March 1, 2019 from Long-term debt to Short-term debt.

### **Total Debt to EBITDA**

The Company uses the ratio of total debt to EBITDA as a measure of its ability to repay its outstanding debt obligations. The Company believes that total debt to EBITDA is a meaningful metric to investors in evaluating the Company's long term financial liquidity and may be different than the method used by other companies to calculate total debt to EBITDA. EBITDA and the ratio of total debt to EBITDA are non-GAAP financial measures. The ratio of total debt to EBITDA represents total debt divided by net income before interest expense, other income (expense), income taxes, depreciation and amortization and impairment of intangible assets on a trailing twelve month basis. Total debt to EBITDA for the trailing twelve month periods ended March 31, 2018 and December 31, 2017 was as follows:

<b>Dollars in millions</b>	<b>March 31, 2018</b>	<b>December 31, 2017</b>
Total debt	\$ 7,549	\$ 8,328
Net income	\$ 1,803	\$ 1,687
Add:		
Interest expense	262	260
Other income	(51)	(45)
Income taxes	1,567	1,583
Depreciation	262	256
Amortization and impairment of intangible assets	201	206
EBITDA	\$ 4,044	\$ 3,947
Total debt to EBITDA ratio	1.9	2.1

### **Stockholders' Equity**

The changes to stockholders' equity during 2018 were as follows:

<b>In millions</b>	
Total stockholders' equity, December 31, 2017	\$ 4,589
Net income	652
Adoption of new accounting guidance	(415)
Repurchases of common stock	(500)
Cash dividends declared	(264)
Foreign currency translation adjustments, net of tax	83
Other	18
Total stockholders' equity, March 31, 2018	\$ 4,163

The adoption of new accounting guidance included cumulative-effect adjustments of \$406 million related to the tax consequences of intra-entity asset transfers and \$9 million related to revenue recognition. Refer to Note 1. Significant Accounting Policies in Item 1. Financial Statements for additional information.

### **FORWARD-LOOKING STATEMENTS**

This document contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of words such as "believe," "expect," "plans," "intends," "may," "strategy," "prospects," "estimate," "project," "target," "anticipate," "guidance," "forecast," and other similar words, including, without limitation, statements regarding the expected performance of acquired businesses and impact of divested businesses, economic conditions in various geographic regions, the timing and amount of share repurchases, the timing and amount of benefits from the Company's enterprise initiatives, the adequacy of internally generated funds and credit facilities to service debt and finance the Company's capital allocation priorities, the sufficiency of U.S. generated cash to fund cash requirements in the U.S., the impact of the recently enacted U.S. tax legislation, the cost and availability of additional financing, the Company's portion of future benefit payments related to pension and postretirement benefits, the availability of raw materials and energy, the expiration of any one of the Company's patents, the cost of compliance with environmental regulations, the likelihood of

future goodwill or intangible asset impairment charges, the impact of failure of the Company's employees to comply with applicable laws and regulations, the impact of foreign currency fluctuations, the outcome of outstanding legal proceedings, the impact of adopting new accounting pronouncements, and the estimated timing and amount related to the resolution of tax matters. These statements are subject to certain risks, uncertainties, and other factors, which could cause actual results to differ materially from those anticipated. Important risks that may influence future results include (1) weaknesses or downturns in the markets served by the Company, (2) changes or deterioration in international and domestic political and economic conditions, (3) the timing and amount of benefits from the Company's enterprise initiatives and their impact on organic revenue growth, (4) market conditions and availability of financing to fund the Company's share repurchases, (5) the risk of intentional acts of the Company's employees, agents or business partners that violate anti-corruption and other laws, (6) the unfavorable impact of foreign currency fluctuations, (7) a delay or decrease in the introduction of new products into the Company's product lines or failure to protect the Company's intellectual property, (8) the potential negative impact of acquisitions on the Company's profitability and returns, (9) negative effects of divestitures, including retained liabilities and unknown contingent liabilities, (10) potential negative impact of impairments to goodwill and other intangible assets on the Company's profitability and return on invested capital, (11) increases in funding costs or decreases in credit availability due to market conditions or changes to the Company's credit ratings, (12) raw material price increases and supply shortages, (13) unfavorable tax law changes and tax authority rulings, (14) financial market risks to the Company's obligations under its defined benefit pension plans, (15) potential adverse outcomes in legal proceedings, (16) uncertainties related to climate change regulation, and (17) negative effects of service interruptions, data corruption, cyber-based attacks, network security breaches, or violations of data privacy laws. A more detailed description of these risks is contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. These risks are not all inclusive and given these and other possible risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

Any forward-looking statements made by ITW speak only as of the date on which they are made. ITW is under no obligation to, and expressly disclaims any obligation to, update or alter its forward-looking statements, whether as a result of new information, subsequent events or otherwise.

ITW practices fair disclosure for all interested parties. Investors should be aware that while ITW regularly communicates with securities analysts and other investment professionals, it is against ITW's policy to disclose to them any material non-public information or other confidential commercial information. Shareholders should not assume that ITW agrees with any statement or report issued by any analyst irrespective of the content of the statement or report.

#### **ITEM 4. Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's Chairman & Chief Executive Officer and Senior Vice President & Chief Financial Officer of the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of March 31, 2018. Based on such evaluation, the Company's Chairman & Chief Executive Officer and Senior Vice President & Chief Financial Officer have concluded that, as of March 31, 2018, the Company's disclosure controls and procedures were effective.

In connection with the evaluation by management, including the Company's Chairman & Chief Executive Officer and Senior Vice President & Chief Financial Officer, no changes in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the quarter ended March 31, 2018 were identified that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II – OTHER INFORMATION**

#### **ITEM 1A. Risk Factors**

The Company's business, financial condition, results of operations and cash flows are subject to various risks which could cause actual results to vary materially from recent results or from anticipated future results. The following is an update to the Company's risk factors and should be read in conjunction with the risk factors previously disclosed in Part I - Item 1A - Risk Factors in the Company's 2017 Annual Report on Form 10-K.

**If the Company is unable to protect its information technology infrastructure against service interruptions, data corruption, cyber-based attacks or network security breaches, or if there is a violation of data privacy laws, there could be a negative impact on operating results or the Company may suffer financial or reputational damage.**

The Company relies on information technology networks and systems, including the Internet, to process, transmit and store electronic information, and to manage or support a variety of business processes and activities, including procurement,

manufacturing, distribution, invoicing and collection. These technology networks and systems may be susceptible to damage, disruptions or shutdowns due to failures during the process of upgrading or replacing software, databases or components; power outages; hardware failures; attacks by computer hackers; computer viruses; employee error or malfeasance. In addition, security breaches could result in unauthorized disclosure of confidential information or personal data belonging to our employees, partners, customers or suppliers. We are also subject to data privacy laws in the various countries in which we operate. If our information technology systems suffer severe damage, disruption, or shutdown, and business continuity plans do not effectively resolve the issues in a timely manner, or if we violate data privacy laws, there could be a negative impact on operating results or the Company may suffer financial or reputational damage.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On February 13, 2015, the Company's Board of Directors authorized a stock repurchase program which provides for the repurchase of up to \$6.0 billion of the Company's common stock over an open-ended period of time (the "2015 Program"). As of March 31, 2018, there were approximately \$1.9 billion of authorized repurchases remaining under the 2015 Program. Share repurchase activity under the Company's share repurchase program for the first quarter of 2018 was as follows:

**In millions except per share amounts**

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Program</b>	<b>Maximum Value of Shares That May Yet Be Purchased Under Program</b>
January 2018	0.3	\$ 175.43	0.3	\$ 2,393
February 2018	2.2	\$ 162.96	2.2	\$ 2,036
March 2018	0.5	\$ 162.09	0.5	\$ 1,945
Total	3.0		3.0	

**ITEM 6. Exhibits**

**Exhibit Index**

<u>Exhibit Number</u>	<u>Exhibit Description</u>
<a href="#"><u>10*</u></a>	<a href="#"><u>Offer of Employment Letter from Illinois Tool Works Inc. to Norman D. Finch Jr. dated January 4, 2017</u></a>
<a href="#"><u>31</u></a>	<a href="#"><u>Rule 13a-14(a) Certification.</u></a>
<a href="#"><u>32</u></a>	<a href="#"><u>Section 1350 Certification.</u></a>
101	The following financial and related information from the Illinois Tool Works Inc. Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 is formatted in Extensible Business Reporting Language (XBRL) and submitted electronically herewith: (i) Statement of Income, (ii) Statement of Comprehensive Income, (iii) Statement of Financial Position, (iv) Statement of Cash Flows and (v) related Notes to Financial Statements.

\* Management contract or compensatory plan or arrangement.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ILLINOIS TOOL WORKS INC.

Dated: May 4, 2018

By: /s/ Randall J. Scheuneman  
Randall J. Scheuneman  
Vice President & Chief Accounting Officer  
(Principal Accounting Officer and Duly Authorized Officer)

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## Section 2: EX-10 (EXHIBIT 10)

### Exhibit 10

January 4, 2017

Norman D. Finch, Jr.  
200 Oakmont Lane  
Waxhaw, North Carolina 28173

Dear Norm:

On behalf of Illinois Tool Works Inc. ("ITW"), we are pleased to extend an offer of employment to you as Senior Vice President - General Counsel. This letter outlines the specifics of our offer of employment.

#### **Compensation:**

- **Base Salary:** You are offered a base salary of \$520,000 per year, which is payable bi-weekly, based on 26 pay periods per year. Base salary is subject to required withholdings. Your initial eligibility for a salary review will be in the first quarter of 2018.
- **Short-Term Incentive Plan:** You are eligible to participate in ITW's Executive Incentive Plan (EIP), with a target award of 70% of your base salary. The incentive is based on ITW financial performance (current measures include operating income and organic revenue growth), and the payout range is 0 - 200% of your target. EIP incentive payouts are payable in the first quarter of the following year (based on your salary as of 12/31). Additional information will be provided after your start date.
- **Long-Term Incentive Plan:** You will be eligible to participate in the ITW Long-Term Incentive Plan (LTIP). This plan is provided to ITW executives to recognize their leadership role in driving the long-term success of the company. Shortly after your start of employment with ITW, you will receive a special LTIP award with a cash value in the amount of \$1,550,000, to be split equally between stock options and restricted stock units (RSUs)(the stock options will vest 25% a year over 4 years and the RSUs vest 3 years from the grant date). This award is intended to compensate you for the near-term value of your unvested long-term incentive awards from your current employer. The grant date for this special award will be on the first trading day of the month following your hire date.

Additionally, provided that you are hired on or before February 10, 2017, you will also be recommended to receive an annual 2017 LTIP grant with a cash value of \$825,000 (subject to approval by the Compensation Committee of the Board of Directors meeting on that date). Half of this LTIP award will be performance-based (payable in shares and cash at the end of the three-year performance period). The other half of the LTIP award will be options (vesting 25% over 4 years). Additional details will be provided at the time of grant.

- **Sign on Bonus:** You will be paid a one-time Sign-On Bonus of \$230,000, less applicable tax withholdings, within 30 days of your hire date. This payment will be subject to supplemental withholding and to your execution of the attached Sign-On Bonus Agreement.

#### **Employee Benefits**

- **Group Insurance Programs:** You and your family are eligible for ITW's comprehensive benefits, subject to the requirements established for each plan. Our plans currently include Medical and Prescription Drug, Dental, Flexible Spending, Wellness, Basic and Voluntary Life and Accident Insurance, Dependent Life, and Disability. Specifics of our plans are in the attached Employer Benefits Summary. You will be eligible to participate in these plans the first day of the month following your date of hire. If your hire date is the first day of a month, your benefits are effective that day.
- **401(k) Plan:** You may participate in ITW's 401(k) Plan and contribute a portion of your salary, through payroll deduction, to a retirement savings program on a pre-tax basis or after-tax basis. You are immediately eligible to receive a company matching contribution if you save under the plan.
- **ECRIP:** You are also eligible to participate in the ITW ECRIP, which is our nonqualified deferred compensation program, starting in 2017.



2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of the annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 4, 2018

/s/ E. Scott Santi

E. Scott Santi

Chairman & Chief Executive Officer

Rule 13a-14(a) Certification

I, Michael M. Larsen, certify that:

1. I have reviewed this report on Form 10-Q of Illinois Tool Works Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of the annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 4, 2018

/s/ Michael M. Larsen

Michael M. Larsen

Senior Vice President & Chief Financial Officer

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## Section 4: EX-32 (EXHIBIT 32)

Section 1350 Certification

The following statement is being made to the Securities and Exchange Commission solely for purposes of Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350), which carries with it certain criminal penalties in the event of a knowing or willful misrepresentation.

Each of the undersigned hereby certifies that the Quarterly Report on Form 10-Q for the period ended March 31, 2018 fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of the registrant.

Dated: May 4, 2018

/s/ E. Scott Santi

E. Scott Santi

Chairman & Chief Executive Officer

Dated: May 4, 2018

/s/ Michael M. Larsen

Michael M. Larsen

Senior Vice President & Chief Financial Officer

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