

ILLINOIS TOOL WORKS INC
Form 10-Q
October 28, 2016

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 September 30, 2016

OR

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

For the transition period from _____ to _____

Commission File Number: 1-4797

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

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

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

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

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer X

Accelerated filer ___

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

Smaller reporting company ___

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

Yes []

No [X]

The number of shares of registrant's common stock, \$0.01 par value, outstanding at September 30, 2016: 351,004,744.

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Part I – Financial Information

Item 1 – Financial Statements

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

| | Three Months | | Nine Months | |
|--|---------------|---------|---------------|----------|
| | Ended | | Ended | |
| | September 30, | | September 30, | |
| In millions except per share amounts | 2016 | 2015 | 2016 | 2015 |
| Operating Revenue | \$3,495 | \$3,354 | \$10,200 | \$10,130 |
| Cost of revenue | 2,027 | 1,953 | 5,890 | 5,947 |
| Selling, administrative, and research and development expenses | 604 | 581 | 1,818 | 1,819 |
| Amortization and impairment of intangible assets | 56 | 59 | 170 | 176 |
| Operating Income | 808 | 761 | 2,322 | 2,188 |
| Interest expense | (58) | (59) | (174) | (168) |
| Other income (expense) | 13 | 23 | 34 | 65 |
| Income Before Taxes | 763 | 725 | 2,182 | 2,085 |
| Income Taxes | 228 | 214 | 654 | 636 |
| Net Income | \$535 | \$511 | \$1,528 | \$1,449 |
| Net Income Per Share: | | | | |
| Basic | \$1.51 | \$1.40 | \$4.28 | \$3.92 |
| Diluted | \$1.50 | \$1.39 | \$4.25 | \$3.90 |
| Cash Dividends Per Share: | | | | |
| Paid | \$0.55 | \$0.485 | \$1.65 | \$1.455 |
| Declared | \$0.65 | \$0.55 | \$1.75 | \$1.52 |
| Shares of Common Stock Outstanding During the Period: | | | | |
| Average | 353.5 | 365.1 | 357.3 | 369.3 |
| Average assuming dilution | 355.5 | 367.1 | 359.3 | 371.6 |

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

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

| | Three Months | | Nine Months | |
|--|---------------|---------------|---------------|---------------|
| | Ended | | Ended | |
| In millions | September 30, | September 30, | September 30, | September 30, |
| | 2016 | 2015 | 2016 | 2015 |
| Net Income | \$535 | \$511 | \$1,528 | \$1,449 |
| Other Comprehensive Income (Loss): | | | | |
| Foreign currency translation adjustments, net of tax | (5) | (335) | 15 | (743) |
| Pension and other postretirement benefit adjustments, net of tax | 7 | 11 | 21 | 31 |
| Comprehensive Income (Loss) | \$537 | \$187 | \$1,564 | \$737 |

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

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

| In millions | September 30, 2016 | December 31, 2015 |
|---|-----------------------|----------------------|
| Assets | | |
| Current Assets: | | |
| Cash and equivalents | \$ 2,299 | \$ 3,090 |
| Trade receivables | 2,496 | 2,203 |
| Inventories | 1,167 | 1,086 |
| Prepaid expenses and other current assets | 223 | 341 |
| Total current assets | 6,185 | 6,720 |
| Net plant and equipment | 1,702 | 1,577 |
| Goodwill | 4,711 | 4,439 |
| Intangible assets | 1,480 | 1,560 |
| Deferred income taxes | 467 | 346 |
| Other assets | 1,164 | 1,087 |
| | \$ 15,709 | \$ 15,729 |
| Liabilities and Stockholders' Equity | | |
| Current Liabilities: | | |
| Short-term debt | \$ 1,364 | \$ 526 |
| Accounts payable | 582 | 449 |
| Accrued expenses | 1,180 | 1,136 |
| Cash dividends payable | 228 | 200 |
| Income taxes payable | 132 | 57 |
| Total current liabilities | 3,486 | 2,368 |
| Noncurrent Liabilities: | | |
| Long-term debt | 6,329 | 6,896 |
| Deferred income taxes | 131 | 256 |
| Other liabilities | 970 | 981 |
| Total noncurrent liabilities | 7,430 | 8,133 |
| Stockholders' Equity: | | |
| Common stock | 6 | 6 |
| Additional paid-in-capital | 1,174 | 1,135 |
| Income reinvested in the business | 19,223 | 18,316 |
| Common stock held in treasury | (14,147) | (12,729) |
| Accumulated other comprehensive income (loss) | (1,468) | (1,504) |
| Noncontrolling interest | 5 | 4 |
| Total stockholders' equity | 4,793 | 5,228 |
| | \$ 15,709 | \$ 15,729 |

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

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

| | Nine Months Ended September 30, | |
|--|---------------------------------------|----------|
| In millions | 2016 | 2015 |
| Cash Provided by (Used for) Operating Activities: | | |
| Net income | \$1,528 | \$1,449 |
| Adjustments to reconcile net income to cash provided by (used for) operating activities: | | |
| Depreciation | 182 | 180 |
| Amortization and impairment of intangible assets | 170 | 176 |
| Change in deferred income taxes | (228) | (35) |
| Provision for uncollectible accounts | 7 | 6 |
| (Income) loss from investments | (5) | (1) |
| (Gain) loss on sale of plant and equipment | 2 | 1 |
| (Gain) loss on sale of operations and affiliates | 6 | (16) |
| Stock-based compensation expense | 31 | 33 |
| Other non-cash items, net | (4) | 7 |
| Change in assets and liabilities, net of acquisitions and divestitures: | | |
| (Increase) decrease in- | | |
| Trade receivables | (198) | (157) |
| Inventories | (47) | (32) |
| Prepaid expenses and other assets | (30) | 22 |
| Increase (decrease) in- | | |
| Accounts payable | 23 | 13 |
| Accrued expenses and other liabilities | (8) | (88) |
| Income taxes | 209 | 38 |
| Other, net | — | — |
| Net cash provided by (used for) operating activities | 1,638 | 1,596 |
| Cash Provided by (Used for) Investing Activities: | | |
| Acquisition of businesses (excluding cash and equivalents) and additional interest in affiliates | (456) | (6) |
| Additions to plant and equipment | (202) | (209) |
| Proceeds from investments | 17 | 17 |
| Proceeds from sale of plant and equipment | 11 | 19 |
| Proceeds from sales of operations and affiliates | 1 | 29 |
| Other, net | (8) | (3) |
| Net cash provided by (used for) investing activities | (637) | (153) |
| Cash Provided by (Used for) Financing Activities: | | |
| Cash dividends paid | (593) | (542) |
| Issuance of common stock | 74 | 48 |
| Repurchases of common stock | (1,482) | (2,002) |
| Net proceeds from (repayments of) debt with original maturities of three months or less | 188 | (662) |
| Proceeds from debt with original maturities of more than three months | 1 | 1,098 |
| Repayments of debt with original maturities of more than three months | (1) | (1) |
| Excess tax benefits from stock-based compensation | 25 | 18 |
| Other, net | (11) | (11) |
| Net cash provided by (used for) financing activities | (1,799) | (2,054) |
| Effect of Exchange Rate Changes on Cash and Equivalents | 7 | (378) |
| Cash and Equivalents: | | |

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| | | |
|--|---------|---------|
| Increase (decrease) during the period | (791) | (989) |
| Beginning of period | 3,090 | 3,990 |
| End of period | \$2,299 | \$3,001 |
| Supplementary Cash and Non-Cash Information: | | |
| Cash Paid During the Period for Interest | \$198 | \$178 |
| Cash Paid During the Period for Income Taxes, Net of Refunds | \$648 | \$585 |

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

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

(1) Financial Statements

The unaudited financial statements included herein have been prepared by Illinois Tool Works Inc. and Subsidiaries (the "Company"). In the opinion of management, the interim financial statements reflect all adjustments of a normal recurring nature necessary for a fair statement of the results for interim periods. It is suggested that these financial statements be read in conjunction with the financial statements and notes to financial statements included in the Company's 2015 Annual Report on Form 10-K. Certain reclassifications of prior year data have been made to conform with current year reporting.

In May 2014, the Financial Accounting Standards Board ("FASB") issued authoritative guidance to change the criteria for revenue recognition. The core principle of the new standard is that revenue should be recognized to depict the transfer 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, several new revenue recognition disclosures will be required. This guidance is effective for the Company beginning January 1, 2018. The Company is currently assessing the potential impact the guidance will have upon adoption.

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 lease asset for all leases, including operating leases, with a lease term greater than twelve months 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, several new disclosures will be required. This guidance is effective for the Company beginning January 1, 2019. The Company is currently assessing the potential impact the guidance will have upon adoption.

In March 2016, the FASB issued authoritative guidance that includes several changes to simplify the accounting for stock-based compensation, including the accounting for income taxes, forfeitures, statutory tax withholding requirements and classification of tax benefits in the statement of cash flows. The new guidance will require that the income tax effects associated with the settlement of stock-based awards after adoption of the guidance be recognized through income tax expense rather than directly in equity. The income tax effects related to excess tax benefits will also be presented as an operating cash flow in the statement of cash flows rather than a financing activity for all periods presented. This guidance is effective for the Company beginning January 1, 2017, with early adoption permitted. For the nine months ended September 30, 2016 and 2015, the Company classified \$25 million and \$18 million, respectively, of excess tax benefits as a financing activity in the statement of cash flows which will be presented as an operating cash flow under the new guidance. The expected effect on income tax expense or operating cash flows for stock-based awards settled after adoption of the new guidance will depend on inputs such as the stock price and the number of stock-based awards settled in the period presented.

In August 2016, the FASB issued authoritative guidance to clarify the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. The objective of the new guidance is to reduce the diversity in practice of the presentation and classification of certain transactions. This guidance is effective for the Company beginning January 1, 2018, with early adoption permitted. The adoption of this standard is not expected to have a material impact.

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 current guidance. The new guidance is effective for the Company beginning January

1, 2018, with early adoption permitted. The Company is currently assessing the potential impact the guidance will have upon adoption.

(2) Income Taxes

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 \$104 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 2017. 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.

(3) Inventories

Inventories as of September 30, 2016 and December 31, 2015 were as follows:

| In millions | September 30, 2016 | December 31, 2015 |
|-------------------|-----------------------|----------------------|
| Raw material | \$ 430 | \$ 415 |
| Work-in-process | 145 | 130 |
| Finished goods | 674 | 622 |
| LIFO reserve | (82) | (81) |
| Total inventories | \$ 1,167 | \$ 1,086 |

(4) Goodwill and Intangible Assets

Goodwill represents the excess cost over fair value of the net assets of purchased businesses. The Company does not amortize goodwill and intangible assets that have indefinite lives. The Company performs an impairment assessment of goodwill and intangible assets with indefinite lives annually, or more frequently if triggering events occur, based on the estimated fair value of the related reporting unit or intangible asset. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

When performing its annual impairment assessment, the Company evaluates the goodwill assigned to each of its reporting units for potential impairment by comparing the estimated fair value of the relevant reporting unit to the carrying value. The Company uses various Level 2 and Level 3 valuation techniques to determine the fair value of its reporting units, including discounting estimated future cash flows based on a detailed cash flow forecast prepared by the relevant reporting unit and market multiples of relevant public companies. If the fair value of a reporting unit is less than its carrying value, an impairment loss, if any, is recorded for the difference between the implied fair value and the carrying value of the reporting unit's goodwill.

The Company's indefinite-lived intangible assets consist of trademarks and brands. The estimated fair values of these intangible assets are determined based on a Level 3 valuation method using a relief-from-royalty income approach derived from internally forecasted revenues of the related products. If the fair value of the trademark or brand is less than its carrying value, an impairment loss is recorded for the difference between the estimated fair value and carrying value of the intangible asset.

The Company performed its annual impairment assessment of goodwill and indefinite-lived intangible assets in the third quarter of 2016 and 2015. The assessment resulted in no impairment charges in 2016. In 2015, the Company recorded a \$2 million indefinite-lived intangible asset impairment charge related to a brand in the Polymers & Fluids segment which had a fair value of \$24 million and a carrying value of \$26 million.

(5) Pension and Other Postretirement Benefits

Pension and other postretirement benefit costs for the three and nine months ended September 30, 2016 and 2015 were as follows:

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|--|-------------------------------------|-------|-------------------------------------|------|------------------------------------|-------|-------------------------------------|-------|
| | Pension | | Other Postretirement Benefits | | Pension | | Other Postretirement Benefits | |
| In millions | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Components of net periodic benefit cost: | | | | | | | | |
| Service cost | \$15 | \$18 | \$ 2 | \$ 3 | \$47 | \$54 | \$ 7 | \$ 8 |
| Interest cost | 23 | 23 | 6 | 6 | 70 | 69 | 18 | 18 |
| Expected return on plan assets | (36) | (38) | (6) | (7) | (109) | (114) | (17) | (19) |
| Amortization of actuarial loss | 11 | 15 | — | — | 32 | 45 | — | — |
| Amortization of prior service income | — | — | — | — | — | — | (1) | — |
| Net periodic benefit cost | \$13 | \$18 | \$ 2 | \$ 2 | \$40 | \$54 | \$ 7 | \$ 7 |

The Company expects to contribute approximately \$73 million to its pension plans and \$5 million to its other postretirement plans in 2016. As of September 30, 2016, contributions of \$66 million to pension plans and \$4 million to other postretirement plans have been made.

(6) Debt

Short-term debt as of September 30, 2016 and December 31, 2015 included commercial paper of \$687 million and \$498 million, respectively. In addition, in the first quarter of 2016, the Company reclassified \$649 million related to the 0.90% notes due February 25, 2017 from Long-term debt to Short-term debt.

During the second quarter of 2016, the Company entered into a \$2.5 billion, five-year line of credit agreement with a termination date of May 9, 2021. This agreement replaced the existing \$1.5 billion line of credit agreement with a termination date of June 8, 2017 and \$1.0 billion line of credit agreement with a termination date of August 15, 2018. No amount was outstanding under this agreement as of September 30, 2016.

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 September 30, 2016 and December 31, 2015 were as follows:

| In millions | September 30, 2016 | December 31, 2015 |
|----------------|-----------------------|----------------------|
| Fair value | \$ 7,860 | \$ 7,153 |
| Carrying value | 6,979 | 6,897 |

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 and nine months ended September 30, 2016 and 2015:

| In millions | Three Months | | Nine Months | |
|---|--------------------------------|-----------|--------------------------------|-----------|
| | Ended September 30, 2016 | 2015 | Ended September 30, 2016 | 2015 |
| Beginning balance | \$(1,470) | \$(1,046) | \$(1,504) | \$(658) |
| Foreign currency translation adjustments during the period | (15) | (337) | (15) | (711) |
| Foreign currency translation adjustments reclassified to income | — | — | 1 | — |
| Income taxes | 10 | 2 | 29 | (32) |
| Foreign currency translation adjustments, net of tax | (5) | (335) | 15 | (743) |
| Pension and other postretirement benefit adjustments during the period | — | 1 | 1 | (1) |
| Pension and other postretirement benefit adjustments reclassified to income | 11 | 15 | 31 | 45 |
| Income taxes | (4) | (5) | (11) | (13) |
| Pension and other postretirement benefit adjustments, net of tax | 7 | 11 | 21 | 31 |
| Ending balance | \$(1,468) | \$(1,370) | \$(1,468) | \$(1,370) |

Pension and other postretirement benefit adjustments reclassified to income relate to the amortization of actuarial losses and prior service income. Refer to the Pension and Other Postretirement Benefits note for additional information.

The Company designated the €1.0 billion of Euro notes issued in May 2015 and the €1.0 billion of Euro notes issued in May 2014 as hedges of a portion of its net investment in Euro-denominated foreign operations to reduce foreign currency risk associated with the investment in these operations. The carrying values of the Euro notes were \$1.1 billion and \$1.1 billion, respectively, as of September 30, 2016. 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 \$232 million and \$308 million as of September 30, 2016 and December 31, 2015, respectively.

The ending balance of Accumulated other comprehensive income (loss) as of September 30, 2016 and 2015 consisted of cumulative translation adjustment losses, net of tax, of \$1.1 billion and \$1.0 billion, respectively, and unrecognized pension and other postretirement benefits costs, net of tax, of \$358 million and \$362 million, respectively.

(8) Segment Information

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

(9) Acquisition

On July 1, 2016, the Company completed the acquisition of the Engineered Fasteners and Components business ("EF&C") from ZF TRW for a purchase price of approximately \$450 million. EF&C had operating revenue of \$117 million for the three months ended September 30, 2016 which was reported within the Company's Automotive OEM segment. The acquisition of EF&C did not materially affect the Company's results of operations or financial position for any period presented.

Based on preliminary acquisition accounting, the Company allocated \$236 million to goodwill and \$95 million to intangible assets, primarily related to customer relationships and technology. The intangible assets are expected to be amortized on a straight-line

basis over their estimated useful lives ranging from 4 to 19 years. The Company anticipates subsequent acquisition accounting adjustments will change the initial amounts recorded for goodwill and intangible assets, primarily due to the completion of valuations. The allocation of purchase price will be completed as soon as practicable, but no later than one year from the acquisition date.

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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. As of December 31, 2015, the Company had 84 divisions in 57 countries and employed approximately 48,000 persons.

The Company's operations are organized and managed based on similar product offerings and similar end markets, and are reported to senior management as the following seven segments: Automotive OEM; 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 management process is the operating system that is applied in every ITW business. Initially introduced as a manufacturing efficiency tool in the 1980's, ITW has continually refined, improved and expanded 80/20 into a proprietary, holistic business management process that generates significant value for the Company. Through the application of data-driven insights generated by 80/20 practice, ITW focuses on its largest and best opportunities (the "80") and eliminates complexity associated with the less profitable opportunities (the "20"). 80/20 enables ITW businesses to consistently deliver world-class operational excellence in regards to product availability, quality, and innovation, while generating superior financial performance;

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

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

ENTERPRISE STRATEGY

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

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

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

Shift the Company's Core Growth Engine to Organic

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

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

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

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

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

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

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

Based on the financial performance of the divisions that are further along in this process, the Company believes that this framework is capable of delivering above market organic growth in all ITW segments. Many ITW divisions are ready to grow and growing above their respective markets, while the rest of the Company's divisions are at various phases of preparing to grow. ITW management is fully aligned on this plan and very focused on executing it. By the end of 2016, the Company expects approximately 85 percent of its businesses to be ready to grow.

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

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

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

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 2015 Annual Report on Form 10-K.

CONSOLIDATED RESULTS OF OPERATIONS

In the third quarter and year-to-date periods, the Company delivered strong financial results despite a challenging macro environment and foreign currency translation headwinds. The key driver of the Company's financial performance is the continued successful execution of the ITW Business Model and enterprise initiatives as six of seven segments achieved worldwide organic revenue growth and five of seven segments had operating margin at or above 21% in both respective periods. All seven segments had operating margin at or above 21% for the third quarter of 2016.

On July 1, 2016, the Company completed the acquisition of the Engineered Fasteners and Components business ("EF&C") from ZF TRW for a purchase price of approximately \$450 million. EF&C had operating revenue of \$117 million for the three months ended September 30, 2016. EF&C diluted the Company's operating margins by 80 basis points and 20 basis points in the third quarter and year-to-date periods, respectively, due to lower operating margin and acquisition related expenses. The Company expects EF&C to be slightly accretive to earnings in the first twelve months, but expects improved performance in later years through the application of the Company's 80/20 business management process. The operating results of EF&C are reported within the Company's Automotive OEM segment. The acquisition of EF&C did not materially affect the Company's results of operations or financial position for any period presented. Refer to the Acquisitions note in Item 1 - Financial Statements for further information.

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

| Dollars in millions | Three Months Ended | | | Components of Increase (Decrease) | | | | | | Total |
|---------------------|--------------------|--------------------|-----------|-----------------------------------|----------|---------------|------------|------------------|--------|-------|
| | September 30, 2016 | September 30, 2015 | Inc (Dec) | Organic | Acq/Div | Restructuring | Impairment | Foreign Currency | | |
| Operating revenue | \$3,495 | \$3,354 | 4.2 | % 1.6 | % 3.5 | % — | % — | % (0.9) | % 4.2 | |
| Operating income | \$808 | \$761 | 6.2 | % 7.5 | % 0.2 | % (0.5) | % 0.3 | % (1.3) | % 6.2 | |
| Operating margin % | 23.1% | 22.7% | 40 bps | 130 bps | (80) bps | (10) bps | — | — | 40 bps | |

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| Dollars in millions | Nine Months Ended | | Components of Increase (Decrease) | | | | | | | Foreign Currency | Total |
|---------------------|-----------------------|----------|-----------------------------------|---------|----------|---------------|------------|-----|---------|---------------------|-------|
| | September 30, 2016 | 2015 | Inc (Dec) | Organic | Acq/Div | Restructuring | Impairment | | | | |
| Operating revenue | \$10,200 | \$10,130 | 0.7 | % 1.2 | % 1.1 | % — | % — | % — | (1.6)% | 0.7 | % |
| Operating income | \$2,322 | \$2,188 | 6.1 | % 7.7 | % — | % 0.2 | % — | % — | (1.8)% | 6.1 | % |
| Operating margin % | 22.8% | 21.6% | 120 bps | 140 bps | (20) bps | — | — | — | — | 120 bps | |

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- Operating revenue increased in the third quarter and year-to-date periods due to an increase in organic and acquisition revenues, partially offset by the unfavorable effect of foreign currency translation. Organic revenue grew 1.6% and 1.2% in the third quarter and year-to-date periods, respectively, as consumer-facing businesses increased 2% and 3% in each respective period, representing approximately 60% of total revenues. Industrial-facing businesses were flat in the third quarter and declined 1% in the year-to-date periods. Six of seven segments had worldwide organic revenue growth primarily due to higher end market demand, penetration gains and product innovation in each respective period. Organic revenue declined in the Welding segment in each respective period primarily due to lower capital spending in the industrial end markets and sluggish demand in the oil and gas end market. PLS activities associated with the portfolio management component of the Company's Enterprise Strategy reduced organic revenue growth by approximately one percentage point. North American organic revenue increased 0.7% in the third quarter. Growth in the Test & Measurement and Electronics, Automotive OEM, Food Equipment and Construction Products segments was partially offset by the decline in the Welding, Specialty Products and Polymers & Fluids segments. In the year-to-date period, North American organic revenue increased 1.0% as growth in six segments was partially offset by a decline in the Welding segment. Europe, Middle East and Africa organic revenue increased 3.1% and 2.2% in the third quarter and year-to-date periods, respectively, as growth in six segments was partially offset by a decline in the Food Equipment segment in the third quarter and a decline in the Welding segment in the year-to-date period. Asia Pacific organic revenue increased 3.8% in the third quarter primarily due to growth in the Automotive OEM, Test & Measurement and Electronics, Construction Products, Specialty Products and Food Equipment segments, partially offset by a decline in the Welding and Polymers & Fluids segments. In the year-to-date period, Asia Pacific organic revenue increased 1.0% primarily due to growth in the Automotive OEM, Construction Products, Specialty Products and Food Equipment segments, partially offset by a decline in the Welding, Polymers & Fluids and Test & Measurement and Electronics segments. Operating margin of 23.1% in the third quarter increased 40 basis points primarily driven by the benefit of the Company's enterprise initiatives of 120 basis points, positive operating leverage of 30 basis points and favorable price/cost of 10 basis points, partially offset by the dilutive impact of 80 basis points from the EF&C acquisition, additional investment in the business and slightly higher expenses related to certain employee benefits. Operating margin was 22.8% in the year-to-date period, an increase of 120 basis points. The primary driver of the operating margin improvement was the benefit of the Company's enterprise initiatives that contributed 130 basis points. Favorable price/cost and positive operating leverage each contributed 20 basis points and were partially offset by the dilutive impact of 20 basis points from the EF&C acquisition, additional investment in the business and slightly higher expenses related to certain employee benefits. Diluted earnings per share (EPS) of \$1.50 increased 7.9% for the third quarter. In the year-to-date period, EPS of \$4.25 increased 9.0%. Free cash flow was \$543 million and \$1.4 billion in the third quarter and year-to-date periods, respectively. Refer to the Cash Flow section of Liquidity and Capital Resources for a reconciliation of this non-GAAP measure. The Company repurchased approximately 4.3 million and 14.4 million shares of its common stock in the third quarter and year-to-date periods, respectively, for approximately \$500 million and \$1.5 billion, respectively. The Company increased the quarterly dividend by 18.2% in the third quarter of 2016. Total cash dividends of \$195 million and \$593 million were paid in the third quarter and year-to-date periods of 2016, respectively. Adjusted after-tax return on average invested capital was 23.0% for the third quarter and 22.3% for the year-to-date period, an increase of 140 basis points and 180 basis points, respectively. Refer to the Adjusted 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 third quarter and year-to-date periods were as follows:

| Dollars in millions | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|------------------------------------|-------------------------------------|---------|---------------------|-------|---------------------------------|----------|---------------------|---------|
| | Operating Revenue | | Operating Income | | Operating Revenue | | Operating Income | |
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Automotive OEM | \$765 | \$612 | \$166 | \$156 | \$2,091 | \$1,914 | \$512 | \$478 |
| Food Equipment | 544 | 551 | 149 | 144 | 1,578 | 1,564 | 405 | 370 |
| Test & Measurement and Electronics | 516 | 490 | 108 | 82 | 1,487 | 1,469 | 274 | 232 |
| Welding | 361 | 396 | 95 | 98 | 1,125 | 1,255 | 282 | 326 |
| Polymers & Fluids | 422 | 423 | 89 | 80 | 1,283 | 1,310 | 266 | 262 |
| Construction Products | 415 | 409 | 94 | 94 | 1,223 | 1,209 | 278 | 241 |
| Specialty Products | 477 | 479 | 125 | 115 | 1,429 | 1,427 | 373 | 334 |
| Intersegment revenues | (5) | (6) | — | — | (16) | (18) | — | — |
| Unallocated | — | — | (18) | (8) | — | — | (68) | (55) |
| Total | \$3,495 | \$3,354 | \$808 | \$761 | \$10,200 | \$10,130 | \$2,322 | \$2,188 |

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 third quarter and year-to-date periods were as follows:

| Dollars in millions | Three Months Ended September 30, | | | Components of Increase (Decrease) | | | | | |
|---------------------|-------------------------------------|--------|-------------|-----------------------------------|-------------------------|---------------|---------------------|-----------|---|
| | 2016 | 2015 | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | Total | |
| | | | | % | % | % | % | % | % |
| Operating revenue | \$765 | \$612 | 24.8 | % 6.6 | % 19.2 | % — | % (1.0) | % 24.8 | % |
| Operating income | \$166 | \$156 | 7.0 | % 7.9 | % 0.9 | % (0.7) | % (1.1) | % 7.0 | % |
| Operating margin | % 21.8 | % 25.4 | % (360) bps | 30 bps | (370) bps | (20) bps | — | (360) bps | |

| Dollars in millions | Nine Months Ended September 30, | | | Components of Increase (Decrease) | | | | | |
|---------------------|------------------------------------|---------|------------|-----------------------------------|-------------------------|---------------|---------------------|----------|---|
| | 2016 | 2015 | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | Total | |
| | | | | % | % | % | % | % | % |
| Operating revenue | \$2,091 | \$1,914 | 9.2 | % 4.4 | % 6.1 | % — | (1.3) | % 9.2 | % |
| Operating income | \$512 | \$478 | 7.2 | % 8.1 | % 0.3 | % — | (1.2) | % 7.2 | % |
| Operating margin | % 24.5 | % 25.0 | % (50) bps | 80 bps | (140) bps | — | 10 bps | (50) bps | |

Operating revenue increased in the third quarter and year-to-date periods due to the EF&C acquisition and higher organic revenue, partially offset by the unfavorable effect of foreign currency translation.

Organic revenue grew 6.6% and 4.4% in the third quarter and year-to-date periods, respectively, as a result of penetration gains, exceeding worldwide auto build growth of 5% and 4% in the respective periods. North American organic revenue grew 4.7% and 3.8% in the third quarter and year-to-date periods, respectively, versus total North American auto build growth of 2% and 3% in the respective periods. Auto

build growth for the Detroit 3, where the Company has higher content, declined 1% in the third quarter and increased 1% in the year-to-date period.

European organic revenue grew 5.0% and 5.3% in the third quarter and year-to-date periods, respectively. European auto builds declined 2% in the third quarter and grew 3% in the year-to-date period.

Asia Pacific organic revenue increased 20.0% and 7.4% in the third quarter and year-to-date periods, respectively, driven by product penetration gains in China due to new product launches in 2016. China organic revenue growth of 40.2% and 18.5% in the third quarter and year-to-date periods, respectively, exceeded Chinese auto build growth of 23% and 11% in each respective period. Auto builds of foreign automotive manufacturers in China, where the Company has higher content, grew 31% in the third quarter and 10% in the year-to-date period.

Operating margin was 21.8% in the third quarter. The decrease of 360 basis points was driven by the dilutive impact of 370 basis points from the EF&C acquisition. Positive operating leverage of 90 basis points and the net benefits from the Company's enterprise initiatives and cost management of 30 basis points were partially offset by unfavorable price/cost of 90 basis points and higher restructuring expenses.

In the year-to-date period, operating margin of 24.5% decreased 50 basis points primarily due to the dilutive impact of 140 basis points from the EF&C acquisition. Positive operating leverage of 60 basis points and the net benefits from the Company's enterprise initiatives and cost management of 50 basis points were partially offset by unfavorable price/cost of 30 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 institutional/restaurant, food service and food retail markets. Products in this segment include:

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

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

| Dollars in millions | Three Months Ended | | | Components of Increase (Decrease) | | | | | Total |
|---------------------|--------------------|--------------------|-----------|-----------------------------------|-------------------------|---------------|------------------|---------|-------|
| | September 30, 2016 | September 30, 2015 | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | | |
| Operating revenue | \$544 | \$551 | (1.3)% | 0.7 % | —% | — | % (2.0)% | (1.3)% | |
| Operating income | \$149 | \$144 | 3.0 % | 5.2 % | —% | (0.4)% | (1.8)% | 3.0 % | |
| Operating margin | % 27.4 | % 26.3 | % 110 bps | 120 bps | — | (10) bps | — | 110 bps | |
| Dollars in millions | Nine Months Ended | | | Components of Increase (Decrease) | | | | | Total |
| | September 30, 2016 | September 30, 2015 | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | | |
| Operating revenue | \$1,578 | \$1,564 | 1.0 % | 2.8 % | —% | — | % (1.8)% | 1.0 % | |
| Operating income | \$405 | \$370 | 9.4 % | 9.7 % | —% | 1.2 % | (1.5)% | 9.4 % | |
| Operating margin | % 25.7 | % 23.7 | % 200 bps | 160 bps | — | 30 bps | 10 bps | 200 bps | |

Operating revenue decreased in the third quarter due to the unfavorable effect of foreign currency translation, partially offset by organic revenue growth. In the year-to-date period, operating revenue increased due to organic revenue growth, partially offset by the unfavorable effect of foreign currency translation.

Organic revenue increased 0.7% in the third quarter as equipment and service organic revenue grew 0.4% and 1.4%, respectively. In the year-to-date period, organic revenue increased 2.8% as equipment and service organic revenue grew 3.6% and 1.6%, respectively.

North American organic revenue increased 2.7% in the third quarter and 4.3% in the year-to-date periods. North American equipment revenue increased 3.3% in the third quarter primarily due to increased demand in refrigeration and retail and 5.7% in the year-to-date period primarily due to strong end market demand in the retail, refrigeration, warewash and cooking businesses. Service revenue in North America increased 1.6% and 2.0% in the third quarter and year-to-date periods, respectively.

International organic revenue declined 1.9% in the third quarter and grew 0.9% in the year-to-date periods.

International equipment organic revenue decreased 2.9% in the third quarter primarily due to lower demand in the United Kingdom and France and increased 1.0% in the year-to-date period primarily due to growth in Europe.

International service organic revenue grew 1.1% and 0.8% in the third quarter and year-to-date periods, respectively.

Operating margin was 27.4% in the third quarter. The 110 basis point improvement was primarily driven by the net benefits of the Company's enterprise initiatives and cost management of 70 basis points, favorable price/cost of 40 basis points and positive operating leverage of 10 basis points.

In the year-to-date period, operating margin of 25.7% increased 200 basis points primarily driven by positive

- operating leverage of 60 basis points, the net benefits of the Company's enterprise initiatives and cost management of 50 basis points, favorable price/cost of 50 basis points and lower restructuring expenses.

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 third quarter and year-to-date periods were as follows:

| Dollars in millions | Three Months Ended | | Components of Increase (Decrease) | | | | | | |
|---------------------|--------------------|--------|-----------------------------------|---------|-------------------------|---------------|------------------|---------|---|
| | September 30, | | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | Total | |
| | 2016 | 2015 | | | | | | | |
| Operating revenue | \$516 | \$490 | 5.3 | % 6.6 | %—% | — | % (1.3)% | 5.3 | % |
| Operating income | \$108 | \$82 | 33.2 | % 34.0 | %—% | 1.0 | % (1.8)% | 33.2 | % |
| Operating margin % | 21.0 | % 16.6 | % 440 bps | 420 bps | — | 20 bps | — | 440 bps | |

| Dollars in millions | Nine Months Ended | | Components of Increase (Decrease) | | | | | | |
|---------------------|-------------------|------|-----------------------------------|---------|-------------------------|---------------|------------------|-------|--|
| | September 30, | | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | Total | |
| | 2016 | 2015 | | | | | | | |

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| | | | | | | | | | | | | |
|-------------------|---------|---------|------|---|---------|---------|-----|--------|----------|---------|------|---|
| Operating revenue | \$1,487 | \$1,469 | 1.2 | % | 2.5 | % | — | % | (1.3) |) | 1.2 | % |
| Operating income | \$274 | 232 | 18.4 | % | 19.5 | % | 0.8 | % | (1.9) |) | 18.4 | % |
| Operating margin | 18.4 | % | 15.8 | % | 260 bps | 260 bps | — | 10 bps | (10) bps | 260 bps | | |

Operating revenue increased in the third quarter and year-to-date periods due to organic revenue growth, partially offset by the unfavorable effect of foreign currency translation.

Organic revenue increased 6.6% and 2.5% in the third quarter and year-to-date periods, respectively.

Worldwide electronics organic revenue increased 12.5% and 5.8% in the third quarter and year-to-date periods, respectively, primarily due to an increase in the electronics assembly businesses in the North American solar and semi-conductor end markets. Other electronics businesses grew 0.4% in the third quarter, primarily due to growth in Europe in the pressure sensitive adhesives businesses, and declined 0.2% in the year-to-date period primarily due to PLS activities in Asia Pacific.

Organic revenue for the worldwide test and measurement businesses increased 1.4% in the third quarter primarily due to easier year-over-year comparisons across all major regions. In the year-to-date period, organic revenue decreased 0.4% primarily due to the continued softness in oil and gas related end markets and the impact of a weak capital spending environment in North America and Europe.

Operating margin was 21.0% in the third quarter. The increase of 440 basis points was primarily driven by the net benefits resulting from the Company's enterprise initiatives and cost management of 210 basis points, positive operating leverage of 190 basis points and favorable price/cost of 20 basis points.

In the year-to-date period, operating margin of 18.4% increased 260 basis points primarily driven by the net benefits resulting from the Company's enterprise initiatives and cost management of 160 basis points, positive operating leverage of 70 basis points and favorable price/cost of 30 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, MRO, construction, and industrial capital goods markets. Products in this segment include:

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

The results of operations for the Welding segment for the third quarter and year-to-date periods were as follows:

| Dollars in millions | Three Months Ended | | | Components of Increase (Decrease) | | | | | Foreign Currency | Total |
|---------------------|--------------------|--------------------|-----------|-----------------------------------|---------------|------------|---|--------|------------------|-------|
| | September 30, 2016 | September 30, 2015 | Inc (Dec) | Organic | Restructuring | Impairment | | | | |
| Operating revenue | \$361 | \$396 | (8.9)% | (8.5)% | — | % | — | (0.4)% | (8.9)% | |
| Operating income | \$95 | \$98 | (2.6)% | (3.4)% | 1.5 | % | — | (0.7)% | (2.6)% | |
| Operating margin % | 26.5% | 24.8% | 170 bps | 130 bps | 40 bps | — | — | — | 170 bps | |

| Dollars in millions | Nine Months Ended | | | Components of Increase (Decrease) | | | | | Foreign Currency | Total |
|---------------------|--------------------|--------------------|-----------|-----------------------------------|---------------|------------|-------|--------|------------------|-------|
| | September 30, 2016 | September 30, 2015 | Inc (Dec) | Organic | Restructuring | Impairment | | | | |
| Operating revenue | \$1,125 | \$1,255 | (10.4)% | (9.4)% | — | % | — | (1.0)% | (10.4)% | |
| Operating income | \$282 | \$326 | (13.5)% | (9.8)% | (2.2) | % | (0.9) | (0.6)% | (13.5)% | |
| Operating margin % | 25.1% | 26.0% | (90) bps | (10) bps | (60) bps | (30) bps | — | 10 bps | (90) bps | |

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

Organic revenue decreased 8.5% and 9.4% in the third quarter and year-to-date periods, respectively, due to lower demand in the oil and gas and industrial end markets and the impact of a soft capital spending environment. In the third quarter, organic revenue declined 8% and 9% for equipment and consumables, respectively. In the year-to-date period, organic revenue declined 11% and 8% for equipment and consumables, respectively.

North American organic revenue declined 8.7% and 7.9% in the third quarter and year-to-date periods, respectively, driven by decreases across the oil and gas end markets and industrial end markets primarily related to heavy equipment for agriculture, infrastructure and mining.

International organic revenue decreased 7.8% and 14.9% in the third quarter and year-to-date periods, respectively, primarily due to weak oil and gas end markets in Europe and Asia Pacific.

Operating margin was 26.5% in the third quarter. The increase of 170 basis points was due to the net benefits of the Company's enterprise initiatives and cost management of 250 basis points, favorable price/cost of 40 basis points and lower restructuring expenses, partially offset by negative operating leverage of 160 basis points.

In the year-to-date period, operating margin of 25.1% declined 90 basis points primarily due to negative operating leverage of 190 basis points, higher restructuring expenses, lower variable margins due to product mix from lower sales of higher margin equipment and the unfavorable impact of intangible asset impairment, partially offset by the net benefits of the Company's enterprise initiatives and cost management of 190 basis points and favorable price/cost of 40 basis points.

POLYMERS & FLUIDS

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

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

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

| Dollars in millions | Three Months Ended | | Components of Increase (Decrease) | | | | | | |
|---------------------|--------------------|---------|-----------------------------------|---------|---------|---------------|------------|------------------|---------|
| | September 30, | | Inc (Dec) | Organic | Acq/Div | Restructuring | Impairment | Foreign Currency | Total |
| | 2016 | 2015 | | | | | | | |
| Operating revenue | \$422 | \$423 | — | % 0.8 | % -% | — | % — | % (0.8) | % — |
| Operating income | \$89 | \$80 | 10.6 | % 8.2 | % -% | 1.6 | % 3.0 | % (2.2) | % 10.6 |
| Operating margin % | 21.0 % | 19.0 % | 200 bps | 140 bps | — | 30 bps | 50 bps | (20) bps | 200 bps |
| Dollars in millions | Nine Months Ended | | Components of Increase (Decrease) | | | | | | |
| | September 30, | | Inc (Dec) | Organic | Acq/Div | Restructuring | Impairment | Foreign Currency | Total |
| | 2016 | 2015 | | | | | | | |
| Operating revenue | \$1,283 | \$1,310 | (2.0) | % 1.1 | % (0.3) | % — | % — | % (2.8) | % (2.0) |
| Operating income | \$266 | \$262 | 1.5 | % 4.1 | % (0.3) | % (0.3) | % 0.9 | % (2.9) | % 1.5 |
| Operating margin % | 20.7 % | 20.0 % | 70 bps | 60 bps | — | (10) bps | 20 bps | — | 70 bps |

Operating revenue was flat in the third quarter as organic revenue growth was offset by the unfavorable effect of foreign currency translation. In the year-to-date period, operating revenue decreased primarily due to the unfavorable effect of foreign currency translation, partially offset by organic revenue growth.

Organic revenue increased 0.8% and 1.1% in the third quarter and year-to-date periods, respectively, primarily due to stronger demand in European and South American end markets.

Organic revenue for the worldwide polymers businesses increased 3.7% and 0.9% in the third quarter and year-to-date periods, respectively, primarily driven by an increase in Europe and South America, partially offset by a decline in North America. Organic revenue for the worldwide automotive aftermarket businesses increased 0.4% and 1.8% in the third quarter and year-to-date periods, respectively, primarily driven by an increase in North America. Organic revenue for the worldwide fluids businesses decreased 1.1% in the third quarter due to a decline in North America. Organic revenue for the worldwide fluids businesses increased

0.2% in the year-to-date period primarily driven by an increase in South America, partially offset by a decline in North America.

Operating margin of 21.0% in the third quarter increased 200 basis points primarily driven by the net benefits of the Company's enterprise initiatives and cost management of 140 basis points, lower restructuring expenses and favorable operating leverage of 20 basis points, partially offset by unfavorable price/cost of 20 basis points. In addition, the third quarter of 2015 included the unfavorable impact of intangible asset impairment. See the Goodwill and Intangible Assets note in Item 1 - Financial Statements for further discussion of the Company's annual impairment assessment. In the year-to-date period, operating margin of 20.7% increased 70 basis points primarily driven by the net benefits of the Company's enterprise initiatives and cost management of 80 basis points and favorable operating leverage of 40 basis points, partially offset by the impact of a first quarter 2015 discrete claim recovery of 40 basis points and unfavorable price/cost of 20 basis points.

CONSTRUCTION PRODUCTS

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

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

The results of operations for the Construction Products segment for the third quarter and year-to-date periods were as follows:

| Dollars in millions | Three Months Ended | | | Components of Increase (Decrease) | | | | | | |
|---------------------|--------------------|---------|------------|-----------------------------------|-------------------------|---------------|------------------|---------|----------|----|
| | September 30, | | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | Total | | |
| 2016 | 2015 | % | | | | | | | % | % |
| Operating revenue | \$415 | \$409 | 1.6 | % 1.5 | %(0.2) |)% | — | % 0.3 | % 1.6 | % |
| Operating income | \$94 | \$94 | (0.2) |)% 8.0 | %(0.3) |)% | (8.3) |)% 0.4 | %(0.2) |)% |
| Operating margin | %22.6 | % 23.1 | %(50) bps | 140 bps | — | | (190) bps | — | (50) bps | |
| Dollars in millions | Nine Months Ended | | | Components of Increase (Decrease) | | | | | | |
| | September 30, | | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | Total | | |
| 2016 | 2015 | % | | | | | | | % | % |
| Operating revenue | \$1,223 | \$1,209 | 1.2 | % 3.1 | %(0.2) |)% | — | % (1.7) |)% 1.2 | % |
| Operating income | \$278 | \$241 | 15.4 |)% 17.4 | %(0.2) |)% | 0.4 | %(2.2) |)% 15.4 | % |
| Operating margin | 22.7 | % 19.9 | %(280) bps | 280 bps | (10) bps | | 10 bps | — | 280 bps | |

Operating revenue increased in the third quarter primarily due to organic revenue growth. In the year-to-date period, operating revenue increased primarily due to organic revenue growth, partially offset by the unfavorable effect of foreign currency translation.

Organic revenue increased 1.5% and 3.1% in the third quarter and year-to-date periods, respectively.

North American organic revenue increased 1.1% in the third quarter. Renovation/remodel increased 3.5% and commercial increased 5.2% due to higher demand, partially offset by a decline of 1.3% in residential. In the year-to-date period, North American organic revenue grew 3.1% driven by growth of 5.0% in renovation/remodel,

6.1% in commercial and 0.6% in residential.

International organic revenue increased 1.9% and 3.2% in the third quarter and year-to-date periods, respectively. Asia Pacific organic revenue increased 2.1% and 3.6% in the third quarter and year-to-date periods, respectively, primarily due to growth in Australia and New Zealand. European organic revenue increased 1.6% and 2.8% in the third quarter and year-to-date periods, respectively, primarily due to growth in the United Kingdom.

Operating margin was 22.6% in the third quarter. The decrease of 50 basis points was driven by higher restructuring expenses of 190 basis points, partially offset by the net benefits of the Company's enterprise initiatives and cost

management of 60 basis points, favorable price/cost of 50 basis points and positive operating leverage of 30 basis points.

- In the year-to-date period, operating margin of 22.7% increased 280 basis points primarily driven by the net benefits of the Company's enterprise initiatives and cost management of 140 basis points, positive operating leverage of 80 basis points and favorable price/cost of 60 basis points.

SPECIALTY PRODUCTS

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

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

The results of operations for the Specialty Products segment for the third quarter and year-to-date periods were as follows:

| Dollars in millions | Three Months Ended | | | Components of Increase (Decrease) | | | | | Total |
|---------------------|--------------------|--------------------|-----------|-----------------------------------|-------------------------|---------------|------------------|---------|-------|
| | September 30, 2016 | September 30, 2015 | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | | |
| Operating revenue | \$477 | \$479 | (0.6)% | 0.1 % | — % | — | (0.7)% | (0.6)% | |
| Operating income | \$125 | \$115 | 8.3 % | 7.8 % | — % | 1.6 | (1.1)% | 8.3 % | |
| Operating margin | 26.1 % | 24.0 % | 210 bps | 180 bps | — | 40 bps | (10) bps | 210 bps | |
| Dollars in millions | Nine Months Ended | | | Components of Increase (Decrease) | | | | | Total |
| | September 30, 2016 | September 30, 2015 | Inc (Dec) | Organic | Acquisition/Divestiture | Restructuring | Foreign Currency | | |
| Operating revenue | \$1,429 | \$1,427 | 0.1 % | 1.2 % | — % | — | (1.1)% | 0.1 % | |
| Operating income | \$373 | \$334 | 11.7 % | 11.4 % | — % | 1.5 | (1.2)% | 11.7 % | |
| Operating margin | 26.1 % | 23.4 % | 270 bps | 230 bps | — | 40 bps | — | 270 bps | |

Operating revenue decreased in the third quarter primarily due to the unfavorable effect of foreign currency translation, partially offset by organic revenue growth. In the year-to-date period, operating revenue increased due to organic revenue growth, partially offset by the unfavorable effect of foreign currency translation.

Organic revenue increased 0.1% and 1.2% in the third quarter and year-to-date periods, respectively, primarily driven by growth in the consumer packaging businesses.

North American organic revenue declined 1.4% in the third quarter due to a decline in the equipment businesses, partially offset by an increase in the consumer packaging businesses. North American organic revenue increased 1.1% in the year-to-date period driven by growth in the consumer packaging businesses, partially offset by the decline in

the equipment businesses.

International organic revenue increased 2.8% and 1.4% in the third quarter and year-to-date periods, respectively, driven by growth in Europe and Asia Pacific.

Operating margin was 26.1% in the third quarter. The increase of 210 basis points was primarily driven by the net benefits of the Company's enterprise initiatives and cost management of 180 basis points and lower restructuring expenses.

In the year-to-date period, operating margin of 26.1% increased 270 basis points primarily driven by the net benefits of the Company's enterprise initiatives and cost management of 210 basis points and lower restructuring expenses.

OTHER FINANCIAL HIGHLIGHTS

Interest expense was \$58 million and \$59 million in the third quarter of 2016 and 2015, respectively. Interest expense of \$174 million in the year-to-date period increased from \$168 million in 2015, primarily due to the Euro notes issued in May 2015.

Other income (expense) was income of \$13 million in the third quarter of 2016, a decrease of \$10 million primarily driven by the impact of foreign currency translation losses and lower interest income, partially offset by an increase in equity investment income. Other income (expense) was income of \$34 million in the year-to-date period, a decrease of \$31 million primarily due to a \$15 million gain on the sale of a business in the first quarter of 2015, lower interest income and a \$6 million loss on the anticipated sale of a business in the second quarter of 2016, partially offset by higher equity investment income.

The effective tax rate for the year-to-date period of 2016 was 30.0% compared to 30.5% in 2015.

NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board ("FASB") issued authoritative guidance to change the criteria for revenue recognition. The core principle of the new standard is that revenue should be recognized to depict the transfer 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, several new revenue recognition disclosures will be required. This guidance is effective for the Company beginning January 1, 2018. The Company is currently assessing the potential impact the guidance will have upon adoption.

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 lease asset for all leases, including operating leases, with a lease term greater than twelve months 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, several new disclosures will be required. This guidance is effective for the Company beginning January 1, 2019. The Company is currently assessing the potential impact the guidance will have upon adoption.

In March 2016, the FASB issued authoritative guidance that includes several changes to simplify the accounting for stock-based compensation, including the accounting for income taxes, forfeitures, statutory tax withholding requirements and classification of tax benefits in the statement of cash flows. The new guidance will require that the income tax effects associated with the settlement of stock-based awards after adoption of the guidance be recognized through income tax expense rather than directly in equity. The income tax effects related to excess tax benefits will also be presented as an operating cash flow in the statement of cash flows rather than a financing activity for all periods presented. This guidance is effective for the Company beginning January 1, 2017, with early adoption permitted. For the nine months ended September 30, 2016 and 2015, the Company classified \$25 million and \$18 million, respectively, of excess tax benefits as a financing activity in the statement of cash flows which will be presented as an operating cash flow under the new guidance. The expected effect on income tax expense or operating cash flows for stock-based awards settled after adoption of the new guidance will depend on inputs such as the stock price and the number of stock-based awards settled in the period presented.

In August 2016, the FASB issued authoritative guidance to clarify the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. The objective of the new guidance is to reduce the diversity in practice of the presentation and classification of certain transactions. This guidance is effective for the Company beginning January 1, 2018, with early adoption permitted. The adoption of this standard is not expected to have a material impact.

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 current guidance. The new guidance is effective for the Company beginning January 1, 2018, with early adoption permitted. The Company is currently assessing the potential impact the guidance will have 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 \$2.3 billion of cash on hand at September 30, 2016 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 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 third quarter and year-to-date periods of 2016 and 2015 was as follows:

| In millions | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2016 | September 30, 2015 | September 30, 2016 | September 30, 2015 |
| Net cash provided by operating activities | \$624 | \$706 | \$1,638 | \$1,596 |
| Additions to plant and equipment | (81) | (62) | (202) | (209) |
| Free cash flow | \$543 | \$644 | \$1,436 | \$1,387 |
| Cash dividends paid | \$(195) | \$(177) | \$(593) | \$(542) |
| Repurchases of common stock | (482) | (216) | (1,482) | (2,002) |
| Acquisition of businesses (excluding cash and equivalents) and additional interest in affiliates | (454) | — | (456) | (6) |
| Net proceeds from (repayment of) debt | 499 | (7) | 188 | 435 |
| Other | 36 | 75 | 109 | 117 |
| Effect of exchange rate changes on cash and equivalents | (3) | (176) | 7 | (378) |
| Net increase (decrease) in cash and equivalents | \$(56) | \$143 | \$(791) | \$(989) |

Stock Repurchase Programs

On August 2, 2013, the Company's Board of Directors authorized a stock repurchase program which provided for the buyback of up to \$6.0 billion of the Company's common stock over an open-ended period of time (the "2013 Program"). Under the 2013 Program, the Company repurchased approximately 14.9 million shares of its common stock at an average price of \$96.84 in the first quarter of 2015. The 2013 Program was completed in the first quarter of 2015.

On February 13, 2015, the Company's Board of Directors authorized a new 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 1.6 million shares of its common stock at an average price of \$97.19 in the first quarter of 2015, approximately 1.9 million shares of its common stock at an average price of \$97.19 in the second quarter of 2015, approximately 2.6 million shares of its common stock at an average price of \$84.45 in the third quarter of 2015, approximately 5.3 million shares of its common stock at an average price of \$94.07 in the first quarter of 2016, approximately 4.8 million shares of its common stock at an

average price of \$104.54 in the second quarter of 2016, and approximately 4.3 million shares of its common stock at an average price of \$116.27 in the third quarter of 2016. As of September 30, 2016, there were approximately \$3.9 billion of authorized repurchases remaining under the 2015 Program.

Adjusted After-Tax Return on Average Invested Capital

The Company uses adjusted 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. Adjusted 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, as well as the Company's equity investment in the Wilsonart business (formerly the Decorative Surfaces segment). Average invested capital is calculated using balances at the start of the period and at the end of each quarter.

ROIC for the third quarter and year-to-date periods of 2016 and 2015 was as follows:

| Dollars in millions | Three Months Ended | | Nine Months Ended | |
|---|--------------------|----------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Operating income | \$808 | \$761 | \$2,322 | \$2,188 |
| Tax rate | 30.0 | % 29.6 | % 30.0 | % 30.5 |
| Income taxes | (243) | (225) | (697) | (668) |
| Operating income after taxes | \$565 | \$536 | \$1,625 | \$1,520 |
| Invested capital: | | | | |
| Trade receivables | \$2,496 | \$2,339 | \$2,496 | \$2,339 |
| Inventories | 1,167 | 1,153 | 1,167 | 1,153 |
| Net plant and equipment | 1,702 | 1,601 | 1,702 | 1,601 |
| Goodwill and intangible assets | 6,191 | 6,088 | 6,191 | 6,088 |
| Accounts payable and accrued expenses | (1,762) | (1,635) | (1,762) | (1,635) |
| Other, net | 393 | 313 | 393 | 313 |
| Total invested capital | \$10,187 | \$9,859 | \$10,187 | \$9,859 |
| Average invested capital | \$9,973 | \$10,038 | \$9,821 | \$10,039 |
| Adjustment for Wilsonart (formerly the Decorative Surfaces segment) | (116) | (121) | (114) | (126) |
| Adjusted average invested capital | \$9,857 | \$9,917 | \$9,707 | \$9,913 |
| Adjusted return on average invested capital | 23.0 | % 21.6 | % 22.3 | % 20.5 |

ROIC increased 140 basis points for the quarter ended September 30, 2016 compared to 2015 as a result of a 5.5% improvement in after-tax operating income and a 0.6% decrease in adjusted average invested capital. Additionally, ROIC increased 180 basis points for the year-to-date period ended September 30, 2016 compared to 2015 as a result of a 6.9% improvement in after-tax operating income and a 2.1% decrease in adjusted average invested capital.

Working Capital

Management uses working capital as a measurement of the short-term liquidity of the Company. Net working capital as of September 30, 2016 and December 31, 2015 is summarized as follows:

| In millions | September 30, 2016 | December 31, 2015 | Increase/ (Decrease) |
|---------------------------------------|-----------------------|----------------------|-------------------------|
| Current assets: | | | |
| Cash and equivalents | \$ 2,299 | \$ 3,090 | \$ (791) |
| Trade receivables | 2,496 | 2,203 | 293 |
| Inventories | 1,167 | 1,086 | 81 |
| Other | 223 | 341 | (118) |
| Total current assets | 6,185 | 6,720 | (535) |
| Current liabilities: | | | |
| Short-term debt | 1,364 | 526 | 838 |
| Accounts payable and accrued expenses | 1,762 | 1,585 | 177 |
| Other | 360 | 257 | 103 |
| Total current liabilities | 3,486 | 2,368 | 1,118 |
| Net working capital | \$ 2,699 | \$ 4,352 | \$ (1,653) |

The decrease in net working capital as of September 30, 2016 was primarily driven by lower cash and equivalents from share repurchases and increased short-term debt due to current maturities of long-term debt.

Cash and equivalents totaled approximately \$2.3 billion as of September 30, 2016 and \$3.1 billion as of December 31, 2015, primarily all of which was held by international subsidiaries. The reduction in cash on hand was primarily driven by share repurchases. Cash and equivalents held internationally may be subject to U.S. income taxes and foreign withholding taxes if repatriated to the U.S. Cash and equivalents balances held internationally are 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.

Debt

Total debt as of September 30, 2016 and December 31, 2015 was as follows:

| In millions | September 30, 2016 | December 31, 2015 |
|-----------------|-----------------------|----------------------|
| Short-term debt | \$ 1,364 | \$ 526 |
| Long-term debt | 6,329 | 6,896 |
| Total debt | \$ 7,693 | \$ 7,422 |

Short-term debt as of September 30, 2016 and December 31, 2015 included commercial paper of \$687 million and \$498 million, respectively. In addition, in the first quarter of 2016, the Company reclassified \$649 million related to the 0.90% notes due February 25, 2017 from Long-term debt to Short-term debt.

During the second quarter of 2016, the Company entered into a \$2.5 billion, five-year line of credit agreement with a termination date of May 9, 2021. This agreement replaced the existing \$1.5 billion line of credit agreement with a termination date of June 8, 2017 and \$1.0 billion line of credit agreement with a termination date of August 15, 2018. No amount was outstanding under this agreement as of September 30, 2016.

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 September 30, 2016 and December 31, 2015 was as follows:

| Dollars in millions | September 30, 2016 | December 31, 2015 |
|--|-----------------------|----------------------|
| Total debt | \$ 7,693 | \$ 7,422 |
| Net income | \$ 1,978 | \$ 1,899 |
| Add: | | |
| Interest expense | 232 | 226 |
| Other income | (47 |) (78 |
| Income taxes | 838 | 820 |
| Depreciation | 246 | 244 |
| Amortization and impairment of intangible assets | 227 | 233 |
| EBITDA | \$ 3,474 | \$ 3,344 |
| Total debt to EBITDA ratio | 2.2 | 2.2 |

Stockholders' Equity

The changes to stockholders' equity during 2016 were as follows:

| In millions | |
|--|----------|
| Total stockholders' equity, December 31, 2015 | \$5,228 |
| Net income | 1,528 |
| Cash dividends declared | (621) |
| Repurchases of common stock | (1,500) |
| Stock option and restricted stock activity | 119 |
| Foreign currency translation adjustments, net of tax | 15 |
| Other | 24 |
| Total stockholders' equity, September 30, 2016 | \$4,793 |

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 acquisition or disposition of businesses, economic conditions in various geographic regions, the timing and amount of share repurchases, the Company's Enterprise Strategy and its ability to manage its strategic business initiatives and the timing and amount of benefits therefrom, 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 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 in, or reduction in, introducing new products into the Company's product lines or failure to protect the Company's intellectual property, (8) negative effects of divestitures, including retained liabilities and unknown contingent liabilities, (9) potential negative impact of impairments to goodwill and other intangible assets on the Company's profitability and return on invested capital, (10) increases in funding costs or decreases in credit availability due to market conditions or changes to the Company's credit ratings, (11) raw material price increases and supply shortages, (12) unfavorable tax law changes and tax authority rulings, (13) financial market risks to the Company's obligations under its defined benefit pension plans, (14) potential adverse outcomes in legal proceedings, (15) negative effects of service interruptions, data corruption, cyber-based attacks or network security breaches and (16) the potential negative impact of acquisitions on the Company's profitability and returns. 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, 2015 and updated in Part II - Other Information - Item 1A - Risk Factors below. 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 the Company speak only as of the date on which they are made. The Company 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.

The Company practices fair disclosure for all interested parties. Investors should be aware that while the Company regularly communicates with securities analysts and other investment professionals, it is against the Company's policy to disclose to them any material non-public information or other confidential commercial information. Shareholders should not assume that the Company 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 September 30, 2016. Based on such evaluation, the Company's Chairman & Chief Executive Officer and Senior Vice President & Chief Financial Officer have concluded that, as of September 30, 2016, 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 September 30, 2016 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 2015 Annual Report on Form 10-K.

The Company's acquisition of businesses could negatively impact its profitability and returns. Acquisitions, including the Company's acquisition of the Engineered Fasteners and Components business on July 1, 2016 from ZF TRW, involve a number of risks and financial, accounting, managerial and operational challenges, including the following, any of which could adversely affect the Company's profitability and returns:

- The acquired business could under-perform relative to the Company's expectations and the price paid for it, or not perform in accordance with the Company's anticipated timetable.
- The acquired business could cause the Company's financial results to differ from expectations in any given fiscal period, or over the long term.
- Acquisition-related earnings charges could adversely impact operating results.
- The acquired business could place unanticipated demands on the Company's management, operational resources and financial and internal control systems.
- The Company may assume unknown liabilities, known contingent liabilities that become realized or known liabilities that prove greater than anticipated, internal control deficiencies or exposure to regulatory sanctions resulting from the

acquired business's activities. The realization of any of these liabilities or deficiencies may increase the Company's expenses, adversely affect its financial position or cause noncompliance with its financial reporting obligations. As a result of acquisitions, the Company has in the past recorded significant goodwill and other identifiable intangible assets on its balance sheet. If the Company is not able to realize the value of these assets, it may recognize charges relating to the impairment of these assets.

The Company's results are impacted by global economic conditions. Downturns in the markets served by the Company could adversely affect its businesses, results of operations or financial condition.

The Company's businesses are impacted by economic conditions around the globe, including the uncertainty created by the United Kingdom's vote to leave the European Union. Slower economic growth, financial market instability, high unemployment, government deficit reduction, sequestration and other austerity measures impacting the markets we serve can adversely affect the Company's businesses by reducing demand for the Company's products and services, limiting financing available to the Company's customers, increasing order cancellations and the difficulty in collecting accounts receivable, increasing price competition, and increasing the risk that counterparties to the Company's contractual arrangements will become insolvent or otherwise unable to fulfill their obligations.

The global nature of the Company's operations subjects it to political and economic risks that could adversely affect its business, results of operations or financial condition.

The Company currently operates in 57 countries. The risks inherent in the Company's global operations include:

- fluctuation in currency exchange rates;
- limitations on ownership or participation in local enterprises;
- price controls, exchange controls and limitations on repatriation of earnings;
- transportation delays and interruptions;
- political, social and economic instability and disruptions;
- acts of terrorism;
- government embargoes or foreign trade restrictions;
- the imposition of duties and tariffs and other trade barriers;
- import and export controls;
- labor unrest and current and changing regulatory environments;
- the potential for expropriation or nationalization of enterprises;
- difficulties in staffing and managing multi-national operations;
- limitations on its ability to enforce legal rights and remedies; and
- potentially adverse tax consequences.

On June 23, 2016, the United Kingdom voted to leave the European Union which may increase certain of the risks and uncertainties described above. The United Kingdom represented approximately 5% of the Company's total consolidated operating revenue for the year ended December 31, 2015. If the Company is unable to successfully manage these and other risks associated with managing and expanding its international businesses, the risks could have a material adverse effect on the Company's business, results of operations or financial condition.

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 September 30, 2016, there were approximately \$3.9 billion of authorized repurchases remaining under the 2015 Program.

Share repurchase activity under the Company's share repurchase program for the third quarter of 2016 was as follows:

In millions except per share amounts

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Value of Shares That May Yet Be Purchased Under Program |
|----------------|----------------------------------|------------------------------|--|---|
| July 2016 | 0.8 | \$106.55 | 0.8 | \$ 4,363 |
| August 2016 | 1.5 | \$118.99 | 1.5 | \$ 4,179 |
| September 2016 | 2.0 | \$117.99 | 2.0 | \$ 3,946 |
| Total | 4.3 | | 4.3 | |

Item 6 –
Exhibits
Exhibit
Index

Exhibit
Number

Exhibit Description

31 Rule 13a-14(a) Certification.

32 Section 1350 Certification.

101 The following financial and related information from the Illinois Tool Works Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2016 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.

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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: October 27, 2016 By: /s/ Randall J. Scheuneman

Randall J. Scheuneman

Vice President & Chief Accounting Officer

(Principal Accounting Officer and Duly Authorized Officer)