3M

**Q2 2020 Earnings Call Transcript**
**Michael Roman, Nicholas Gangestad, & Monish Patolawala**
**July 28, 2020**

**Slide 1, Cover Page**

**Slide 2, Upcoming Investor Events**
**Bruce Jermeland, Vice President, Investor Relations**

Thank you and good morning everyone. Welcome to our second quarter 2020 business review.

With me today are Mike Roman, 3M's chief executive officer, along with Nick Gangestad and Monish Patolawala, our chief financial officers. As you may know, Nick will be retiring at the end of July. Monish joined the 3M team on July 1st, succeeding Nick as CFO. Mike, Nick and Monish will make some formal comments and then we will take your questions.

Please note that today's earnings release and slide presentation accompanying this call are posted on our investor relations website at 3M.com under the heading 'quarterly earnings.'

Please turn to slide 2.

Let me remind you to mark your calendars for our third quarter earnings call which will take place on Tuesday, October 27th.

**Slide 3, Forward Looking Statement**
**Bruce Jermeland**

Please take a moment to read the forward-looking statement on slide three. During today's conference call, we will make certain predictive statements that reflect our current views about 3M's future performance and financial results. These statements are based on certain assumptions and expectations of future events that are subject to risks and uncertainties. Item 1A of our most recent form 10Q lists some of the most important risk factors that could cause actual results to differ from our predictions.

Finally, throughout today's presentation we will be making references to certain non-GAAP financial measures. Reconciliations of the non-GAAP measures can be found in the attachments to today's press release. Please note we have provided segment and total company adjusted EBITDA reconciliations for reference in today's press release attachments as part of our non-GAAP measures.

Please turn to slide four and I will hand it off to Mike.

Mike.

**Slide 4, CEO Key Messages**
**Mike Roman, Chairman and Chief Executive Officer**

Thank you, Bruce.

Good morning, everyone – I hope you and your families are staying safe and healthy, and I thank you for joining us.

We continue to fight the pandemic from all angles to ensure the safety of our employees, healthcare workers, first-responders, and the public.

In a highly uncertain environment where economic activity was restricted by global lockdowns, we executed well and delivered another strong operational performance in the second quarter.

We posted solid margins and robust cash flow while strengthening our balance sheet, innovating for our customers, investing in the future, and continuing our transformation.

Our value model is strong, and we are taking action on a number of fronts to lead through this crisis and emerge even stronger.

While there remains a great deal of economic uncertainty, we are seeing an improvement in sales trends in July across all businesses and geographies as we start the third quarter and Monish will provide additional comments later in the call.

I am proud of how our team is leading through these unprecedented times and I thank all 3Mers for their tireless efforts to serve those who count on us.

Please turn to slide 5.

**Slide 5, Pandemic response**
**Mike Roman**

Our COVID-19 response starts with a steadfast commitment to the health of our employees.

We have robust safety protocols in our manufacturing plants and distribution sites enabling us to effectively protect our people, while maintaining supply chain operations.

For remote employees, we have developed a phased approach for their return to the workplace with enhanced safety measures, and emphasis on flexibility for individuals.

We have had our colleagues return to the workplace in two dozen countries – mainly in Asia and EMEA – along with our global R&D community and we are adjusting based on government guidelines and the evolution of the pandemic across the world.

As we protect employees, we work around the clock to protect the safety of all people including healthcare workers and first responders.

3M is making and distributing more respirators than ever before though demand continues to far outpace what the entire industry can supply.

In the first half of the year, 3M manufactured 800 million respirators globally with half distributed in the U.S., primarily to healthcare and FEMA.

For the full year, we expect to produce 2 billion respirators globally – more than a 3-fold increase versus 2019.

We continue to make investments, and partner with the U.S. Department of Defense and other governments, to bring additional global capacity online.

We are also working with federal, state and local governments to deliver respirators where the need is greatest.

At the same time, we remain vigilant in fighting fraud and price gouging; to date 3M has filed 18 lawsuits, and removed over 7,000 counterfeit websites, protecting people from bad actors.

Beyond personal protective equipment, 3M science is fighting COVID-19 in other areas as well.

Our membrane technologies help improve blood oxygenation procedures and our biopharma solutions support the development of needed vaccines and therapeutics.

Earlier this month, we announced a collaboration with MIT on a diagnostic COVID-19 test that aspires to make testing faster, more broadly available, and less expensive.

The project has received approval from the National Institutes of Health, and we are working as fast as we can to develop a low-cost, highly accurate device that can be mass-produced.

I will now turn to our second-quarter results on slide 6.

**Slide 6, Q2 2020 Summary**
**Mike Roman**

The financial impact of the pandemic remained mixed across 3M during Q2.

We continue to see strong demand in personal safety, along with other areas such as home improvement, general cleaning and biopharma filtration.

At the same time, we experienced steep, but expected, declines in other end markets including medical and dental elective procedures, automotive OEM and aftermarket, and general industrial.

Geographically, while organic sales in Asia Pacific declined 8 percent, we saw year-over-year improvement in China, up 3 percent in the quarter, versus down 11 percent in Q1.

Organic growth trends in EMEA and the Americas remained consistent throughout the quarter, both declining in the mid-teens each month.

All-in, organic sales companywide was minus 13 percent, with adjusted earnings of $1.78 per share.

While growth conditions were challenging, our operational execution was strong.

We expanded adjusted EBITDA margins to 26.5 percent, up 110 basis points year-on-year.

In the second quarter we delivered $400 million in cost savings versus last year as we aggressively managed expenses to offset COVID-19 impacts and associated restructuring.

This cost discipline, along with effective capital allocation, enabled us to increase our adjusted free cash flow to $1.5 billion in the second quarter and Nick will walk you through the details.

Please turn to slide 7.

**Slide 7, Advancing 3M's Strategic Priorities**
**Mike Roman**

Importantly, while we manage near-term uncertainty, we continue to advance our four strategic priorities – portfolio, transformation, innovation, and people and culture – to deliver value for our customers and shareholders.

We finalized the sale of our drug delivery business in May, enabling us to focus more on our core health care portfolio.

We are encouraged at the benefits we are seeing from the new global operating model we implemented this year, a significant step in our transformation.

This includes our new enterprise operations team, which is enabling us to reduce cycle times and improve the customer experience.

Nearly all of our plants and distribution centers are operational, and we have worked with our partners to ensure consistency of supply.

Our new structure streamlines decision-making and allows us to adjust faster than ever to the external environment, all of which help our customers.

As just one example, one of our U.S. plants recently pivoted to manufacturing hand sanitizer almost overnight, moving from formulation to production in less than 72 hours.

In addition, we're accelerating our efforts on automation and robotics, and introducing new digital capabilities – such as virtual selling tools – to deliver on our promises to customers.

At the heart of 3M is innovation, and our ability to apply science to solve critical customer needs.

We continue to invest in R&D, and drive innovations to solve big challenges like air quality, automotive electrification and food safety, just a few of our priority growth platforms, which are outperforming in the markets they serve.

For example, our air quality platform grew double-digits in the quarter as we introduced new indoor air quality solutions through our innovation and increased investments in capital.

We are also finding new ways to engage our people, strengthen our culture and advance our core values.

We continue to step up our leadership in sustainability and our annual sustainability report, released in May, includes a comprehensive look at our progress.

As part of this commitment, we are proactively managing PFAS, guided by the principles of sound science, corporate responsibility and transparency.

For example, in March we launched a clearinghouse to share research on testing, measurement and remediation, a commitment we made at our congressional testimony last fall. You can find this clearinghouse, and all the latest information on PFAS, on our website at 3M.com. In addition, we provide regular updates in our 10-Q filings.

We are also fulfilling our commitment to comprehensive reviews of all 3M manufacturing operations to ensure adherence to environmental requirements, company policies, and our values.

As we shared previously, we continue to work with communities where we manufacture, along with government officials and regulators – including the EPA – to advance our environmental stewardship.

Last week we announced an agreement with the Alabama Department of Environmental Management to resolve matters related to previously disclosed PFAS discharges at our Decatur facility. This is part of our commitment to address contamination at sites where we manufactured or disposed of PFAS.

With respect to PFAS litigation, we anticipate the earliest trial date will now be in 2021.

Beyond our environmental responsibility, we know we and others must do more to address injustice and inequality.

The death of George Floyd, here in Minnesota, was jarring for all 3Mers, especially our African-American employees.

At 3M, we stand for equity, fairness, and social justice, and we will be part of the solution: by listening, understanding, and then acting.

Based on insights from our employees and communities, we have two focus areas.

First, we are identifying the most impactful actions to accelerate inclusion and diversity within 3M – while we've made good progress in recent years, we have much more to do.

At the same time, we are working with other companies on actions that will make a difference here in Minnesota and we have made initial investments as part of these efforts.

We are also working with stakeholders to develop a long-term plan to support economic opportunities and development in communities of color, address the education gap, and advance social justice.

It is vital that companies step up to lead change to really make a difference this time.

I am personally leading these initiatives and we will provide you with updates as we move forward.

Please turn to slide 8.

**Slide 8: CFO Transition**
**Mike Roman**

Before turning the call to Nick, I would like to make a few comments about our CFO transition.

First, I want to thank Nick for his many contributions throughout 35 years at 3M.

He has been an outstanding leader and a great colleague and has created tremendous value for our company and our shareholders.

In six years as CFO, Nick's guidance has been especially valuable as he helped lead our transformation, and our work to optimize our portfolio and position 3M for the future.

I wish Nick and his family all the best in the future.

I am also excited to welcome Monish to our leadership team.

Most recently, Monish was CFO at GE Healthcare, a $17 billion business.

His experience leading healthcare and industrial businesses along with driving operational transformation is already making an immediate impact for 3M.

Monish is an ideal fit for our enterprise and for our culture and later in the call he will make a few comments about our perspective on the third quarter.

I will now turn the call over to Nick for the details on Q2.

Nick.

**Slide 9: Q2 2020 P&L Highlights**
**Nick Gangestad, Senior Vice President and Chief Financial Officer**

Thank you, Mike and good morning everyone. Please turn to slide nine.

Companywide, second-quarter sales were $7.2 billion with adjusted operating income of $1.4 billion and adjusted operating margins of 19.6 percent.

On the right-hand side of this slide you see the components of our margin performance in the second quarter.

The impact of the pandemic was varied and numerous across the business and operations. The biggest factor negatively affecting Q2 operating margins was the impact of the pandemic on global customer demand which resulted in nearly a 14 percent year-on-year decline in organic sales volumes.

In addition, during the quarter, we undertook restructuring actions resulting in a Q2 charge of $58 million due to the impact of the pandemic.

These headwinds were partially offset by aggressive cost management during the quarter which reduced costs by approximately $400 million year-on-year. Also providing a year-on-year benefit to operating margins is a restructuring charge in last year's second quarter.

All-in, these benefits were more than offset by the decline in organic sales volume and restructuring actions resulting in a 100-basis point reduction to second-quarter margins versus last year.

Acquisitions and divestitures, reduced margins by 80 basis points due to Acelity purchase accounting impacts.

Higher selling prices along with lower raw material costs contributed 70 basis points to second quarter margins.

And finally, foreign currency, net of hedging impacts, reduced margins by 10 basis points.

Overall, we effectively managed costs throughout the quarter in a very dynamic and challenging global economy and, as Mike mentioned, we expanded EBITDA margins by 110-basis points year-on-year to 26.5 percent.

Let's now turn to slide ten for a closer look at earnings per share.

**Slide 10, Q2 2020 EPS**
**Nick Gangestad**

Second-quarter adjusted earnings were $1.78 per share, down 16.4 percent year-over-year.

Let me now cover the items that made up our second quarter earnings performance.

Similar to the operating margin discussion on the prior slide, organic sales declines, productivity and other actions collectively reduced year-on-year per share earnings by 28 cents.

Acquisitions and divestitures reduced second quarter earnings by 7 cents per share versus last year, primarily due to the Acelity acquisition. Please note that this result includes financing costs associated with the acquisition.

Foreign-currency, net of hedging, was a 5 cent per share headwind in the quarter.

Turning to tax rate, our second quarter adjusted tax rate was 20.7 percent versus 22.3 percent last year adding 3 cents to earnings per share.

And finally, average diluted shares outstanding declined one percent versus Q2 last year adding 2 cents to per share earnings.

Please turn to slide eleven for a discussion of our cash flow and balance sheet.

**Slide 11, Q2 2020 Cash Flow and Balance Sheet**
**Nick Gangestad**

As Mike noted, we delivered strong second quarter adjusted free cash flow of $1.5 billion, up 18 percent year-over-year. This increase was driven by effective working capital management, disciplined capital allocation along with a $400 million benefit related to timing of income tax payments, which will be paid in the third-quarter.

Through the first half of the year, adjusted free cash flow increased to $2.5 billion versus $2 billion last year as we continue to generate strong free cash flow demonstrating the strength and resiliency of our business model.

From a capital allocation perspective our long-term strategy remains unchanged. Our first priority is to invest in our business, second, maintaining our dividend and lastly flexible deployment for M&A and share repurchases.

Second quarter capital expenditures were $379 million. For the full year, we now anticipate capex expenses of approximately $1.4 billion versus $1.3 billion previously. This increase in our full-year capex budget expectations is primarily due to the pace of projects picking back up as economic activity returns.

During the second quarter we returned $846 million to our shareholders via dividends. Share repurchases remained suspended throughout the quarter, given the continued global economic uncertainty.

Our strong second quarter cash flow generation and disciplined capital allocation enabled us to strengthen our capital structure. We ended the quarter with $4.5 billion in cash and marketable securities on-hand and reduced net debt by $1.7 billion, or 10 percent, in the second quarter.

Please turn to slide twelve where I will summarize the business group performance for Q2.

**Slide 12, Q2 Business Group Performance**
**Nick Gangestad**

I will start with our Safety and Industrial business which declined 6 percent organically in the quarter.

Personal safety saw strong double-digit organic growth driven by continued unprecedented levels of demand for respirators globally in response to the pandemic.

The balance of the Safety and Industrial portfolio declined significantly due to the global slowdown in industrial production activity during the quarter.

Looking geographically, the Americas declined 9 percent organically with the U.S. down mid-single digits. EMEA declined 1 percent while Asia Pacific was down 4 percent.

Safety and Industrial's second quarter segment operating margins were 23.8 percent, up 180 basis points driven by continued strong productivity, cost actions and benefits from last year's restructuring.

Moving to Transportation and Electronics, second quarter sales were down 19 percent organically compared to last year.

Our electronics-related business was down 1 percent with strong growth in semiconductor, factory automation and datacenter which was offset by continued softness in consumer electronics, particularly smartphones.

Our automotive OEM business was down 44 percent year-on-year, in-line with the 45 percent decline in global car and light truck builds.

Commercial solutions declined roughly 30 percent while transportation safety and advanced materials were down mid- and high-teens, respectively.

Geographically, Asia Pacific declined 8 percent while the Americas declined 29 percent and EMEA was down 33 percent.

Transportation and Electronics second quarter operating margins were 19.7 percent, negatively impacted by the 19 percent decline in organic sales which was partially offset by cost actions and benefits from last year's restructuring.

Turning to Health Care which experienced significant pandemic-related challenges and disruptions across the industry declined 12 percent organically versus last year.

Organic growth across much of our Health Care portfolio was negatively impacted by the effects of COVID which resulted in delays in elective medical procedures and closed most dental offices around the world.

These impacts were most prevalent in our oral care business which was down nearly 60 percent and medical solutions which declined mid-single digits in Q2.

Food safety declined mid-single digits as the business was impacted by the closure of food processing plants during the quarter due to worker safety concerns.

Of positive note, our separation and purification business grew mid-single digits. This business continues to experience strong demand for biopharma filtration solutions in support of the pharmaceutical industry's research and manufacturing efforts to develop vaccines and therapeutic treatments for COVID.

Looking geographically, the Americas declined 14 percent while EMEA and Asia Pacific each declined 10 percent.

Health Care's second quarter operating margins were 16.8 percent, or down nearly 10 percentage points year-on-year. Approximately two-thirds of this decline was due to the significant reduction in organic sales with the remaining one-third related to the Acelity acquisition. Looking ahead, we expect both organic growth and operating margins to improve as elective procedures return.

Lastly, second quarter organic growth for our Consumer business was down 5 percent.

Organic sales growth within Consumer was led by our home care business, up high-single digits along with home improvement which was up low-single digits. Growth in these businesses was driven by strong customer demand for our Scotchbrite cleaning products and solutions ScotchBlue painter's tapes, Filtrete air filtration products and Meguiar's car care products.

Stationery and office and consumer health care both declined, impacted by the stay-at-home orders and social distancing protocols which resulted in many offices and schools being closed across the world.

Looking at Consumer geographically, the Americas and Asia Pacific were each down mid-single digits while EMEA declined 10 percent.

Consumer's operating margins were 23.2 percent, up 250 basis points on strong cost discipline and ongoing productivity.

That wraps up my review of second-quarter results. Before I turn it over to Monish, I would like to take this opportunity to make a few comments given it is my last earnings call.

35-years ago I started my career at 3M right out of college. I am humbled and grateful for the many opportunities and experiences that I have had throughout my career and most importantly the many wonderful people that I have gotten to know both professionally and personally around the world. In the last six years, I have been blessed to be the CFO of this great company and to lead 3M's global finance organization. As part of my role as CFO I have also had the opportunity to engage with many of you in the investor community. I have greatly enjoyed the many interactions with those of you who have covered and invested in 3M. I have appreciated your support, input and feedback and I wish all of you the best in the future.

With that, please turn to slide thirteen, and I will hand it over to Monish to discuss our thoughts going forward.

Monish.

**Slide 13, Q3 2020 insights**
**Monish Patolawala, Senior Vice President and Chief Financial Officer**

Thank you, Nick and good morning everyone.

First, I would like to recognize and thank Nick not only for his 35 years of outstanding service to 3M but also for his partnership, counsel and guidance over the past month in helping me learn 3M and ensure a smooth transition.

Like Nick, I am humbled to be part of this outstanding company. I have had great admiration of 3M and its vast scientific capabilities to positively impact the world including across industry, health care, and consumer's lives. It is great to be part of the leadership team and to lead the company's global finance organization.

Over the past month, I have spent time meeting with Leadership, key finance members, and participated in strategic and operating reviews and discussions. While I have only been on the job for a few weeks, this past month has given me a great opportunity to personally engage with our leadership team and learn the company. I want to thank all 3Mers for their warm welcome.

With that let me make a few remarks regarding our thoughts on the coming quarter.

As we start the third quarter, we are seeing sequential improvements in end-markets including automotive, healthcare and general industrial. While the strength and pace of recovery remains uncertain, we currently are expecting global economic activity to be stronger in Q3 as compared to Q2.

Turning to our business, we are seeing a broad-based pickup in growth across our businesses and geographies as we start the third quarter. With one week left in July, total company sales are currently up low-single digits year-on-year.

With respect to respirators, we anticipate continued strong demand which we estimate will contribute approximately 300 to 350 basis points to companywide Q3 organic growth.

As we did throughout Q2, we will continue to provide monthly sales information. Therefore, we will provide an update on July sales once we have finalized results in a few weeks.

From an operational standpoint, though we anticipate some pickup in costs as sales growth improves, we are maintaining our aggressive cost discipline while also continuing to invest in future growth and productivity. Therefore, looking at margins, we currently anticipate our third-quarter adjusted operating income margins in the range of 20 to 21 percent.

Finally, with respect to free cash flow, we will continue our efforts to drive improvements in working capital and prioritize capex spend. Our ongoing focus on cash flow along with disciplined capital allocation are central to enhancing our financial flexibility and strengthening our capital structure.

While uncertainty remains, we are confident in our ability to continue to execute on our priorities, respond to changes in the marketplace and invest in future growth and productivity.

With that, I thank you for your attention and we will now take your questions.

**Slide 14, Q&A**

(Q&A)

(Host turns the call over to 3M)

**Conclude and Sign off**
**Mike Roman**

To wrap up, the 3M team delivered another strong operational performance in the second quarter.

In a challenging environment, we posted robust cash flow, managed costs and continued to invest for the future.

We will continue to fight COVID-19 from all angles, and we are well-positioned to deliver value for all of our stakeholders during the pandemic and as the economy recovers.

Thank you for joining us.