Q4 2020 Earnings Call Transcript
Michael Roman & Monish Patolawala
January 26, 2021

Slide 1, Cover Page
Bruce Jermeland, Vice President, Investor Relations

Thank you and good morning everyone and welcome to our fourth-quarter earnings conference call. Let me begin today by expressing our sincere hope that you and your families continue to be safe and are doing well.

With me today are Mike Roman, 3M's chairman and chief executive officer, and Monish Patolawala, our chief financial officer. Mike and Monish will make some formal comments and then we will open it up for 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.

Slide 2, Upcoming Investor Events
Bruce Jermeland

Before we begin, I would like to introduce the dates for our 2021 quarterly earnings conference calls which will be held on April 27th, July 27th and October 26th.

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 10K 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, 3M is Delivering and Well Positioned for the Future
Mike Roman, Chairman and Chief Executive Officer

Thank you, Bruce.

Good morning everyone, and thank you for joining us.

The 3M team finished the year strong as we continued to execute well, innovate for our customers, and fight the pandemic from every angle.

In an uncertain economic environment, we delivered organic growth in all business groups and geographic areas, along with margin expansion, a double-digit increase in earnings and strong cash flow during the fourth quarter.

Throughout 2020, I am proud of how 3M stepped up to help meet the extraordinary challenges facing the world… which includes our comprehensive response to COVID-19.

Last year we also took actions to transform for the future, advance our core values and strengthen our balance sheet through robust cash generation.

At the same time, we know that more work remains to deliver for our customers, shareholders and all stakeholders.

Moving forward we will build on our progress, and continue to prioritize investments in growth, productivity and sustainability.

3M is well-positioned as we head into 2021, and today we are providing guidance for the year, where we expect a return to healthy growth.

Overall, I am confident in our ability to deliver a successful 2021, lead through the economic recovery, and capitalize on opportunities from emerging trends that are favorable to 3M and our market-leading businesses.

Please turn to slide 5.

Slide 5, Q4 2020 Performance: Strong Finish to the Year
Mike Roman

Companywide, total sales in the fourth quarter increased to $8.6 billion with organic growth of 6 percent, and earnings of $2.38 per share, up 22 percent year-on-year on an adjusted basis.

Demand remained strong in end-markets such as personal safety, home cleaning and semiconductors and we saw sequential improvement in general industrial and automotive OEM.

We also saw ongoing weakness in other end-markets, including health care and oral care elective procedures, which declined sequentially as they continued to be impacted by COVID-19.

Geographically, organic growth was led by the Americas, up 8 percent with the United States up 9 percent.

EMEA grew 6 percent and Asia Pacific grew 2 percent, with China up 14 percent.

Our team delivered another quarter of good operational performance.

We expanded our adjusted EBITDA margins to over 27 percent, with all business groups above 26 percent and increased our adjusted free cash flow to $2.1 billion.

That wraps up my opening comments.

I will come back to discuss our full-year performance, along with my perspective on 2021, after Monish takes you through the details of the quarter.

Monish.

Slide 6, Q4 2020 P&L Highlights
Monish Patolawala, Senior Vice President and Chief Financial Officer

Thank you Mike and I wish you all a very good morning.

Please turn to slide six.

Companywide, fourth-quarter sales were $8.6 billion, up 5.8 percent year-on-year.

This result was better than we had anticipated. Our personal safety team continued to execute well in expanding respirator production to support pandemic-related demand. We also saw continued end-market strength through year-end in automotive OEM electronics, and home improvement.

Strong operating rigor and disciplined cost management drove robust adjusted operating income of $1.8 billion, up 20 percent with adjusted operating margins of 21.5 percent, up 250 basis points year-on-year.

On the right-hand side of this slide you can see the components that impacted margins.

Organic volume growth along with our ongoing cost management and productivity efforts were the biggest contributor to our margin improvement adding 160 basis points.

Included in this 160-basis point benefit were two items that I had called out during a conference in early December.

First, we exited a product line within our closure, masking and packaging business and sold the related property in Q4. This resulted in a pre-tax gain of $54 million, or a 60-basis point margin benefit. Please note that this gain is included in Safety and Industrial's Q4 operating income.

And second, we increased our respirator mask reserve by $107 million in Q4 which resulted in a 90-basis point headwind to margins year-on-year. For the full year we increased our respirator mask reserve by roughly $130 million, which is a little higher than the $100 million average over the last few years. This increase in our reserve is reflected in Corporate and Unallocated.

As you may have noticed, adjusting for last year's significant litigation charge, our fourth-quarter Corporate and Unallocated expense was up approximately $100 million year-on-year. This increase was primarily driven by the update to our respirator mask reserve along with impacts from ongoing legal costs as we continue to manage PFAS and other legal proceedings.

Turning to selling prices and raw materials which was an 80-basis point year-on-year benefit to margins. This benefit was driven by the combination of higher selling prices and lower raw material costs versus last year's fourth quarter. Note, approximately half of our fourth-quarter selling price performance was benefited by lower year-on-year volume related customer rebates in markets that were most impacted by the pandemic.

Acquisitions and divestitures contributed 10 basis points year-on-year.

Foreign currency, net of hedging impacts, decreased margins by 10 basis points.

And lastly, while the fourth-quarter pre-tax restructuring charge of $137 million was similar to last year's charge restructuring provided a 10 basis benefit to margins year-on-year due to this year's higher sales.

Let’s now turn to slide seven for a closer look at earnings per share.

Slide 7, Q4 2020 EPS
Monish Patolawala

Fourth quarter earnings were $2.38 per share up 22 percent from last year on an adjusted basis.

First, as discussed on the prior slide, organic growth and ongoing cost management and productivity efforts delivered 43 cents per share to earnings growth. This included a 9-cent benefit from the gain on sale of property and a 10-cent headwind from the increased respirator mask reserve.

Acquisitions and divestitures reduced earnings by 2-cents and foreign exchange impacts added 2-cents to per share earnings year-on-year.

The strength of the 3M business model, strong cash flow and liquidity position gave us the opportunity in Q4 to retire $1 billion of debt early that was due to mature in 2021. As a result, we incurred higher net interest in the quarter which combined with higher shares outstanding reduced earnings by 3 cents.

Finally, a lower tax rate versus last year provided a 3-cent benefit to earnings per share. The lower tax rate was primarily a function of the mix of pre-tax income around the world.

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

Slide 8, Q4 2020 Cash Flow and Balance Sheet
Monish Patolawala

We delivered another quarter of robust free cash flow with fourth quarter adjusted free cash flow of $2.1 billion … up 16 percent year-over-year with conversion of 151 percent.

Cash flows in the quarter were primarily driven by robust income and daily management of working capital.

For the full year we generated adjusted free cash flow of $6.7 billion, up 18 percent.

Fourth quarter capital expenditures were $422 million and were $1.5 billion for the year.

During the quarter we returned $848 million to our shareholders via dividends and $3.4 billion for the year.

Share repurchases remained suspended throughout the quarter, given the continued global economic uncertainty.

Our strong fourth quarter cash flow generation and disciplined capital allocation enabled us to continue to strengthen our capital structure.

We ended the quarter with $5.1 billion in cash and marketable securities on-hand and reduced net debt by $1.3 billion, or 9 percent sequentially.

For the year, we improved our net debt position by $4.1 billion, or 23 percent.

As a result, we exited the year with net debt to EBITDA of 1.5 down from 2.3 at the end of 2019.

This significant improvement in our net debt position along with our strong cash flow generation capability provides us increased financial flexibility to invest in our business pursue strategic opportunities and return cash to shareholders while maintaining a strong capital structure.

Please turn to slide nine where I will summarize the business group performance for Q4.

Slide 9, Q4 2020 Business Group Performance
Monish Patolawala

I will start with our Safety and Industrial business which posted organic growth of 11.4 percent year-on-year in the fourth quarter. This result, includes an approximate 10 percentage point benefit from pandemic-related respirator mask demand.

Overall, general industrial manufacturing activity continued to improve during Q4. However, customers and channel partners continued to remain cautious given ongoing macroeconomic uncertainty.

Personal safety posted double-digit organic growth year-on-year driven by continued demand for respirators.

Industrial adhesives and tapes grew mid-single digits while the electrical markets business was up low-single digits.

The strong growth in the residential housing market continued to drive good performance in our roofing granules business which was up double-digits organically versus Q4 of last year.

The rest of the Safety and Industrial portfolio namely automotive aftermarket, abrasives, and closure and masking declined year-on-year.

Safety and Industrial's fourth quarter segment operating margins were 27.7 percent up 690 basis points driven by strong leverage on sales growth and continued productivity and spending discipline along with the previously mentioned gain on sale of real estate.

Moving to Transportation and Electronics after a challenging last two years, fourth quarter organic sales growth turned positive up 1.4 percent as compared to last year.

Our electronics-related business was up 2 percent with continued strong growth in semiconductor, factory automation and data centers which was partially offset by year-on-year softness in consumer electronics.

Our auto OEM business was up 18 percent year-on-year compared to the 3 percent increase in global car and light truck builds. For the full year, our automotive business outperformed global builds by approximately 700 basis points.

Advanced materials and transportation safety returned to growth year-on-year driven by improving end-market trends in automotive and highway infrastructure.

Commercial solutions continued to be down year-on-year due to negative pandemic-related impacts on advertising spend and demand for workplace cleaning and safety products and solutions.

Transportation and Electronics fourth-quarter operating margins were 21.8 percent up 100 basis points on positive sales growth and continued cost discipline.

Turning to Health Care some parts of the world were challenged with rising COVID-19 cases throughout Q4. As a result, those healthcare providers experienced sequential declines in their elective procedure volumes which negatively impacted parts of our business.

At the same time, we continue to experience strong pandemic-related demand for respirators to protect frontline healthcare workers which more than offset the headwinds from the decline in elective procedure volumes.

As a result, our Health Care business delivered fourth-quarter organic sales growth of 6.6 percent versus last year.

The medical solutions business grew low double-digits driven by continued strong respirator demand. Excluding respirators, organic growth in this business was flat.

Our oral care business organic sales were flat year-over-year as it dealt with rising COVID cases.

The separation and purification business increased low double-digits year-on-year. This business continues to experience solid demand for biopharma filtration solutions in support of the pharmaceutical industry's research and manufacturing efforts to develop vaccines and therapeutic treatments for COVID.

Turning to health information systems which declined mid-single digits organically as hospitals continued to remain cautious relative to their information technology investments.

And finally, food safety was up low-single digits organically versus last year.

Health Care's fourth quarter operating margins were 24.7 percent, up 340 basis points year-on-year, with adjusted EBITDA margins of 31.7 percent. Fourth quarter margins were driven by continued strong execution and cost management, which was partially offset by higher year-on-year restructuring costs.

Lastly, fourth quarter organic growth for our Consumer business was up 10 percent as retailers saw continued strong customer demand throughout the holiday season.

Growth in this business continues to be driven by strong consumer demand for our category leading brands, namely Filtrete, Scotch, ScotchBlue, Scotch-Brite, Command, and Meguiar's.

We also continue to see very strong growth in e-commerce channels as the pandemic has accelerated years' worth of changes in consumer shopping behavior.

Organic sales growth within Consumer continued to be led by our home improvement and home care businesses each up double digits organically.

Stationery and office declined low-single digits as many business offices and schools remained partially or fully closed due to the ongoing impact of the pandemic.

Consumer's operating margins were 23.5 percent or similar to last year. As we have previously mentioned, we have been stepping up investments in advertising and merchandising and new product innovation to address changing consumer demand trends. Lastly, similar to Health Care, operating margins were impacted by higher year-on-year restructuring costs.

That wraps up the review of fourth-quarter results please turn to slide ten, and I will hand it back over to Mike.

Mike.

Slide 10, 2020 Full-Year Performance
Mike Roman

Thank you, Monish.

Looking at our 2020 performance, we posted an organic sales decline of 2 percent, and adjusted earnings of $8.74 per share.

We increased adjusted free cash flow by 18 percent to $6.7 billion, with a conversion rate of 132 percent… which demonstrates the strength of our business model, and our continued ability to perform across economic cycles.

Additionally, we posted a good return on invested capital of 18 percent, and expanded our adjusted EBITDA margins to over 27 percent, up 100 basis points year-on-year.

Our strong cash flow, along with disciplined capital allocation, helped us reduce net debt by over $4 billion in the year.

During the year we strengthened our Health Care portfolio with the successful integration of Acelity and the completion of the divestiture of drug delivery.

We returned $3.8 billion to our shareholders through cash dividends and share repurchases… and last year marked our 62nd consecutive year of dividend increases.

Beyond financial results, 2020 was a year where 3M stepped up when we were needed the most.

Please turn to slide 11.

Slide 11, Delivering Today, Building for a Stronger Tomorrow
Monish Patolawala

Throughout the pandemic, 3Mers have been relentless in applying science to improve lives and make the world a better place.

Our COVID-19 response has been guided by three priorities: protecting our employees, fighting the pandemic from every angle, and delivering for our customers and shareholders.

Beginning last January, we immediately activated our surge capacity and doubled our production of respirators to help protect nurses, doctors and first responders.

We have since worked tirelessly to bring on more capacity, which includes additional investments from 3M, and partnerships with governments at all levels.

In total, last year we produced and delivered 2 billion respirators globally, with approximately half in the United States. Today, we are at an annual run rate of 2.5 billion respirators, a 4-fold increase versus 2019.

At the same time, we have worked closely with governments, law enforcement and retailers to fight fraud: to date, we have helped identify more than 8 million counterfeit respirators, protecting healthcare workers from bad actors.

Beyond providing respirators and other important personal protective equipment, we have helped the world recover in other ways.

For example, our biopharma filtration solutions have enabled the development and manufacture of critical vaccines and therapeutics.

We also took significant actions throughout the year to position ourselves for long-term growth and value creation.

We continue to strengthen our innovation – which remains at the center of our 3M model – and last year we invested $3.4 billion in the combination of research and development and cap-ex.

Our team also found ways to innovate differently and faster in response to the pandemic, and to serve growing market trends.

We formed partnerships with other companies to expand respirator production; we introduced new daily face coverings, and we quickly adapted our cleaning product lines to serve new customers.

We created new products to improve indoor air quality, biopharma filtration and automotive electrification just a few of our priority growth platforms.

We rolled out cutting-edge solutions to improve the performance of electric car batteries, one element of our work to enable more sustainable vehicle designs.

For the full year, our priority growth platforms grew 7 percent, outperforming the markets they serve.

We also continue to see benefits from the global operating model we implemented last January.

Our model enabled us to respond to the pandemic with agility and resilience – from our significant expansion of PPE production, to our ability to maintain business continuity, serve our customers and ensure the integrity of our supply chain.

Our Enterprise Operations team is applying learnings from our expansion of respirator production into other areas of 3M; for example, we are deploying new technologies and using our analytic platforms to double our Filtrete capacity.

We also took steps to optimize our model and further streamline our organization, initiating a restructuring in December that will reduce annual operating costs by $250 to $300 million.

In summary, as I look across 2020, I am proud of our accomplishments and our people: from the 50,000 3Mers in our factories to our colleagues who volunteered to relocate and help scale up new respirator lines to the retirees who came back to staff our hotline, answering calls from home.

People across 3M have stepped up to make a difference and I thank our entire team for their incredible contributions in 2020.

Please turn to slide 12.

Slide 12, Positioned for Strong 2021 Performance
Mike Roman

We expect to deliver a strong performance in 2021 with organic growth of 3 to 6 percent, improved earnings, margin expansion and strong cash flow and Monish will take you through the details shortly.

We have aggressively prioritized investments throughout the pandemic, and we will accelerate our efforts in 2021 with ongoing focus on growth, productivity and sustainability.

We will increase investments in areas with strong growth opportunities such as personal safety, home improvement and healthcare with continued emphasis on our priority growth platforms.

The rapid movement to an even more digital-first world also opens additional opportunities for 3M.

We are pioneering innovations that improve performance of data centers and semiconductor manufacturing, which will be more relevant moving forward.

We will also do more to leverage e-commerce, along with digital technologies to better serve our customers.

Ultimately, we have big opportunities to unleash 3M science and drive sustainable, long-term growth, and we will ensure that our teams have the resources to capitalize.

We will continue to advance the digitization of 3M, while also accelerating our use of data and analytics in everything we do.

Further strengthening our supply chain is a priority in 2021 with a focus on highly sustainable, disruptive and safe manufacturing technology, which will help us deliver on our promises to customers and shareholders.

To that end, I want to close by talking about the commitments we will keep in 2021 and beyond, leading our industry in science, society and sustainability.

3M science drives our business forward. We leverage and combine our technologies in unique ways across the company, creating new products and new lines of business, and we are positioned to do even more to deliver differentiated value for our customers into the future.

In a similar way, 3M is partnering with our communities to improve society. In 2020, we took steps to advance our core values, including diversity, equity and inclusion, and in the coming year we will hold ourselves accountable to new goals to support underrepresented groups at 3M, building on our recent progress. We will also be releasing a new global Diversity, Equity and Inclusion report with details on our metrics.

We remain committed to sustainability, which includes using science to proactively manage PFAS, and to enable success in our ongoing work with communities and governments to advance our environmental stewardship.

We will continue to increase investments to make our factories more sustainable including $100 million in investments this year, which is included in our 2021 cap-ex guidance, to further reduce water usage and improve water quality around our manufacturing sites.

To help address questions you have been asking, I would also like to touch on our strong history of working with governments in leveraging science to solve big challenges around the world. We have had productive conversations with President Biden's Transition team, and now the Administration, about their COVID-19 response, and we have open lines of communication. We will continue to do all we can to get respirators and other personal protective equipment to frontline workers, and help America and the world beat the pandemic.

On environmental stewardship, we share a common goal with governments of improving water quality, and doing so in a way that is based on sound science, established regulatory processes and collaboration with a broad range of stakeholders.

We look forward to working with President Biden's Administration and congressional leaders to pursue these shared goals – including through the remediation of PFAS where appropriate – and we aim to build on the successful public-private partnerships that 3M has led globally throughout our history as a company.

To wrap up, we are confident about what's ahead in 2021, and in our ability to create more value from the 3M model and build an even more competitive and sustainable enterprise.

I will now turn the call over to Monish to cover the details of our guidance.

Monish.

Slide 13, Full-year 2021 Planning Estimates
Monish Patolawala

Thanks Mike.

Please turn to slide thirteen.

As Mike mentioned, we are initiating full-year 2021 guidance as end-market visibility has continued to improve despite ongoing macroeconomic uncertainty. As a result, we will no longer be reporting monthly sales updates as we had in 2020.

Looking at sales, we are forecasting total sales growth of 5 to 8 percent with organic growth in the range of 3 to 6 percent.

Earnings per share is projected to be between $9.20 and $9.70, or up 5 to 11 percent on an adjusted basis.

The primary contributors to earnings growth in 2021 include organic sales growth productivity, as we continue to increase our focus on operating rigor through daily management and leveraging the use of data and data analytics and our ongoing efforts to advance and streamline our global operating model.

And lastly, we anticipate benefits from foreign currency due to the weaker U.S. dollar.

Partially offsetting these benefits are anticipated year-on-year headwinds from the Q4 2020 gain on sale of real estate and the expected increase in areas such as travel, variable incentive compensation, and advertising and merchandising investments.

Turning to cash, we expect another year of robust cash flow with free cash flow conversion in the range of 95 to 105 percent.

From a capital allocation perspective, our first priority remains investing organically in our business including R&D and capex.

As we have noted, we are increasing investments in growth, productivity and sustainability in 2021. As a result, capex for the year is expected to be in the range of $1.8 to $2.0 billion.

Returning cash to shareholders remains a high priority for 3M, including both dividends along with a disciplined approach to share repurchases which we plan to restart in 2021.

Please see the appendix in today's slide presentation for additional details regarding our 2021 full-year guidance.

Please turn to slide fourteen.

Slide 14, 2021 Organic Local-Currency Growth Segment Expectations
Monish Patolawala

Here you see a breakdown of our expectations for organic growth by business group along with some of the key macroeconomic and market indicators we incorporated into our planning.

Overall, the pace and success of the COVID-19 vaccine deployment and adoption will be critical for the global economy.

The two broadest macroeconomic indicators global GDP and IPI are both expected to grow mid-single digits.

The overall electronics market is expected to be up mid-single digits.

In addition, global car and light truck builds are expected to grow 14 percent versus 2020.

Also, while healthcare and oral care elective procedures volumes have improved off of the Q2 lows of 2020, they are currently not expected to return to pre-COVID levels until the later part of 2021.

We are also monitoring the ability and pace for people to return to the workplace and students to return to school.

And finally, consumer spending, particularly retail sales and home improvement demand and e-commerce also are factors in our planning.

Taking these factors into account, we expect the following organic growth expectations for our business groups in 2021.

Starting with Safety and Industrial where we anticipate organic local-currency growth to be up mid-single digits.

Transportation and Electronics is expected to be up low- to high-single digits. This wider range contemplates the potential for end-market variability, particularly in automotive and electronics.

And finally, both our Healthcare and Consumer businesses are projected to grow in the low- to mid-single digits this year.

In 2021, we will prioritize capital to our greatest market opportunities deliver for customers drive commercial intensity improve operating rigor enhance daily management leverage data and data analytics and continue to streamline our organization.

As a result, we expect solid revenue growth improved margins and earnings robust free cash flow and a continued strong capital structure and financial flexibility.

To wrap up, in the spirit of continuous improvement, there is always more we can do and will do.

I would like to thank all 3Mers for the hard work and the progress that we have made in an unprecedented year!

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

Slide 15, Q&A
Mike Roman

To wrap up, in Q4 and throughout 2020, our team executed well and continued to fight the pandemic from every angle, while building for the future and advancing our values.

As we look ahead, we will apply 3M science to capitalize on global market trends, and prioritize investments in growth, productivity and sustainability.

We enter 2021 well-positioned to generate greater value for our customers and shareholders, and deliver a strong performance. Thank you for joining us.