Q1 2023 Earnings Call Transcript
Michael Roman and Monish Patolawala
April 25, 2023

Slide 1, Cover page
Bruce Jermeland, Senior Vice President, Investor Relations

Thank you and good morning, everyone and welcome to our first-quarter earnings conference call.

With me today are Mike Roman, 3M's chairman and chief executive officer, and Monish Patolawala, our chief financial and transformation officer. Mike and Monish will make some formal comments then we will take your questions.

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

Please turn to slide 2.

Slide 2, Forward looking statements
Bruce Jermeland

Please take a moment to read the forward-looking statement. During today's conference call, we will be making 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 10-K lists some of the most important risk factors that could cause actual results to differ from our predictions.

Please note, 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.

With that, please turn to slide 3 and I will now hand the call off to Mike.

Slide 3, Streamlining and simplifying 3M to drive growth, margins, and cash
Mike Roman, Chairman and Chief Executive Officer

Thank you, Bruce. Good morning, everyone, and thank you for joining us.

Before I recap our first quarter, I want to discuss actions we are taking to improve our performance.

As you recall, over the past few years we have implemented a new global operating model, led by our four business groups, which included moving to a common global supply chain design end-to-end. We have since advanced our digital capabilities, further repositioned our portfolio, and continued to invest in growth and productivity.

Our experience throughout this journey – including lessons learned during the pandemic, supply chain disruptions, and changing global trends – has shown us what is working, and what we can do better.

As I said last quarter, we are looking at everything we do.

Today, we are announcing additional actions to improve our cost structure, streamline our corporate center, strengthen our supply chain, enhance our go to market models, and drive greater focus in markets where 3M science gives us a clear competitive advantage.

We will reduce costs at the corporate center by eliminating management layers across the company. We are broadly reducing our corporate shared services, like our central design group. We are reducing rooftops worldwide, including exiting our conference center in northern Minnesota. We are also simplifying and modernizing our technology by moving to the cloud and removing hundreds of legacy systems. This reduces costs and provides us greater agility and flexibility to invest in differentiated digital areas like data, analytics, and automation, while increasing investments in cybersecurity.

We are simplifying our supply chain structure to better align with our businesses and improve performance in every aspect of plan, source, make, and deliver, while adding industry expertise to help drive our progress. The actions we are announcing today will help us complete our shift from area to global management, simplifying reporting lines and clarifying accountability. We are also taking out layers of management and duplication of activities across all areas of supply chain. Our progress in digital gives us better tools to use in the areas of planning, sourcing, and logistics, removing redundant work and improving productivity. And we will prioritize our continuous improvement efforts in our largest factory operations. We will have a more efficient support structure and operating model to improve service, cost, and inventory.

We are streamlining go-to-market models to better align with customers, improve agility, and reduce management structure. This is driven by our relentless focus on optimizing the path to our customer. We are not adopting a one-size-fits-all approach; we are customizing an approach for each business that ensures greater focus.

In Safety and Industrial, and Transportation and Electronics, we will eliminate certain area-based business group leadership and move to a division-led model. In Transportation and Electronics, we will also combine two divisions, further reducing structure. In Consumer, we will simplify how we go to market, with each area team aligned around their prioritized product portfolios and leading brands.

In addition, we are changing our go-to-market model in approximately 30 countries around the globe, which represent less than 5% of our revenue. In these countries, we will leverage our digital and export capabilities and move to a model partnering with distributors with deep local knowledge and infrastructure – enabling us to significantly reduce our people, real estate, and other related costs.

Through our actions we plan to eliminate approximately 6,000 positions globally, in addition to the reduction of 2,500 global manufacturing roles we announced in January. In total, this represents about 10% of our global workforce and senior executive roles. Reductions will span all functions, businesses, and geographies, and be completed in accordance with local regulations. We expect to take total pre-tax restructuring charges of $700 million to $900 million, with approximately half of the charges to occur in 2023, and the balance to be largely taken in 2024. We anticipate the actions will drive savings in the range of $700 million to $900 million, expand margins and position 3M for future growth. We estimate that approximately half of the annualized savings will be realized in 2023.

At the same time, we are continuing to build 3M for the future, prioritizing high growth markets like automotive electrification, personal safety, home improvement, semiconductors, and health care. We are also investing in large emerging markets that demand our material science innovation, including climate technology, industrial automation, next-generation electronics, and sustainable packaging.

As we move forward, we will drive additional cost reductions through improvements in sourcing, yield, productivity, factory automation and network optimization of our plants and distribution centers.

Today, we are also announcing changes to align our leadership to our future direction. Effective immediately, Mike Vale is appointed to Group President and Chief Business and Country Officer, a new role on the company's Corporate Operations Committee, reporting to me. In this new role, he will have responsibility for three of the company's four business groups (Safety and Industrial, Transportation and Electronics, and Consumer) and also country governance.

Jeff Lavers, who was leading our Consumer and Health Care businesses, will now lead our Health Care business, and support the company's progress toward a spin off and the transition to a new CEO and management team. Jeff continues to report to me.

Karina Chavez will become Group President, Consumer. Chris Goralski will become Group President, Safety and Industrial. Ashish Khandpur will continue as Group President, Transportation and Electronics. All three are experienced leaders at 3M and well positioned to help drive the actions we announced today to improve our performance. Karina, Chris, and Ashish will report to Mike Vale.

In total, today's actions will make 3M more streamlined and competitive.

Now, please turn to slide 4, for a summary of our first quarter.

Slide 4, Remain focused on our strategies while managing in a challenging environment
Mike Roman

In an economic environment that remains challenging, we stayed relentlessly focused on serving customers and aggressively managed costs.

We posted adjusted organic growth of (5.6%), or (2.2%) excluding our Russia exit and decline in disposable respirator sales. We delivered adjusted margins of nearly 18% and adjusted earnings of $1.97 per share, while expanding our adjusted free cash flow to $900 million. Today, we are affirming our full-year guidance for organic growth, EPS and cash flow, which is inclusive of the restructuring charges and related savings.

End market trends played out as we expected, with ongoing weakness in consumer-facing markets. We saw continued strength in certain industrial markets, including automotive, electrical markets and abrasives.

Our actions to reduce costs – which included plant spending, external services, travel and hiring – helped drive stronger-than-expected earnings and margins. We also continued to improve inventory levels, enabling us to deliver strong cash flow.

At the same time, we are advancing our strategic priorities for long-term value creation, as we make progress on the spin of our health care business.

Turning to litigation, on Combat Arms, 3M continues to support Aearo Technologies through mediation discussions. We are focused on achieving a resolution that is efficient and equitable for all parties.

With respect to PFAS, we continue to address litigation by defending ourselves in court or negotiating resolutions, as appropriate. We also have a dedicated team to facilitate an orderly transition as we exit PFAS manufacturing and work to discontinue the use of PFAS in our products by the end of 2025.

In summary, we are improving day-to-day operational execution, advancing our strategic priorities, and taking necessary actions to move 3M forward.

We are dedicated to building on our progress, delivering greater value for our customers and shareholders, and exiting 2023 a stronger and more focused 3M.

Monish will now take you through the details of the quarter.

Slide 5, Q1 2023 operating margin and EPS
Monish Patolawala, Executive Vice President, Chief Financial & Transformation Officer

Thank you, Mike, and I wish you all a very good morning. Please turn to slide 5.

As Mike mentioned, the first-quarter macro and end-market trends have played out largely as anticipated. We experienced significant end-market weakness in consumer electronics, shifting consumer spending patterns along with retailer destocking, and mixed industrial end-markets. We also continued to navigate COVID-related impacts in China, and the ongoing geopolitical challenges in Europe.

Given the expected challenging start to the year, we relentlessly focused on serving our customers and took very aggressive actions to manage costs and spending. These actions, coupled with a lower-than-expected foreign currency headwind, enabled us to deliver a first quarter that was better than forecasted.

First quarter total adjusted sales were $7.7 billion, or down 9.7% year-on-year. In addition to focusing on serving customers, first quarter sales benefitted from a smaller than anticipated headwind to sales from foreign currency translation. The first quarter year-on-year translation impact was a minus 2.8%, or approximately $230 million, versus a forecast of (3%) to (4%).

We also experienced a 1.3% sales decline from divestitures, or approximately $120 million, versus Q1 last year. This decline was largely from the third quarter 2022 divestiture of Food Safety along with the deconsolidation of Aearo Technologies.

On an adjusted organic basis, first quarter sales decreased 5.6% versus last year. This result included an expected year-on-year headwind of approximately $300 million, or 3.4 percentage points, related to lower disposable respirator demand and the exit of our operations in Russia last year in the third quarter. Excluding this decline, Q1 adjusted organic sales growth was minus 2.2%.

First quarter adjusted operating income was $1.4 billion, with operating margins of 17.9% and adjusted earnings of $1.97.

Turning to the components that impacted first quarter operating margins and earnings year-on-year performance.

Our Q1 margin and earnings reflect the previously mentioned lower sales volume. This lower sales volume, combined with our efforts to reduce inventories, resulted in lower manufacturing productivity versus last year's first quarter. We were able to partially offset these headwinds through pricing performance and aggressive cost management resulting in a net headwind to margins of 90 basis points and $0.17 to earnings.

As mentioned, we faced a challenging Q1 comp from last year's Omicron-driven disposable respirator demand along with the exit of operations in Russia. This sales comp headwind resulted in a negative impact to operating margins of 1.1 percentage points and to earnings of $0.21 per share.

We continued our focus on improving our manufacturing and supply chain operations, including executing on restructuring actions to streamline the organization and adjust to slowing end-market demand.

Restructuring charges in the quarter were $52 million, or a year-on-year headwind of 50 basis points to margins and $0.05 to earnings per share.

The carryover impact of higher raw material, logistics, and energy cost inflation created a year-on-year headwind of approximately $100 million, or a negative 130 basis point impact to operating margins and $0.15 to earnings.

As mentioned, foreign currency translation was a (2.8%) impact to total sales. This resulted in a headwind of 30 basis points to margins and $0.10 to earnings per share.

Divestitures, primarily Food Safety, along with the deconsolidation of Aearo Technologies, resulted in a year-on-year headwind of $0.03 to earnings per share in the quarter.

Finally, other financial items increased earnings by a net $0.05 per share year-on-year, driven by lower share count, partially offset by higher non-op pension expense.

Please turn to slide 6.

Slide 6, Q1 2023 cash flow and balance sheet
Monish Patolawala

First quarter adjusted free cash flow was approximately $950 million, up 24% year on year, with conversion of 87%, up 37 percentage points versus last year's Q1.

This year-on-year improvement was driven by lower annual incentive cash compensation and a strong focus on working capital management, particularly inventory improvement.

During the quarter, we continued to address manufacturing production levels to better align with end-market trends. Since last August, we have driven an approximately $500 million reduction in inventory levels. As I've said before, as supply chains heal and we progress the use of data and data analytics, we will see a reduction in inventory levels.

Adjusted capital expenditures were $445 million in the quarter, up 15% year-on-year, as we continue to invest in growth, productivity, and sustainability.

During the quarter, we returned nearly $900 million to shareholders.

Net debt at the end of Q1 stood at $12.0 billion, down 10% year-on-year, with net debt to EBITDA at 1.5x.

Please turn to slide 8 for our business group performance.

Slide 8, Safety & Industrial
Monish Patolawala

I will start with our Safety and Industrial business which posted sales of $2.8 billion, or down 6.0% organically.

This result included a year-on-year comp headwind of $285 million due to last year's Omicron-driven disposable respirator demand and exit of Russia.

Excluding the impact from disposable respirators and Russia exit, Safety and Industrial's sales grew nearly 4% organically in Q1.

Organic growth was led by high-single digit increases in automotive aftermarket, electrical markets, and abrasives, while the personal safety business declined mid-teens, primarily due to the decline in disposable respirator demand. Excluding the impact from disposable respirators, the personal safety business grew low-double digits organically.

Turning to the rest of Safety and Industrial …

Organic growth declined high-single digits in industrial adhesives and tapes due to consumer electronics softness, and closure and masking systems was down low-single digits as consumers pulled back on discretionary spending impacting e-commerce shipments. Roofing granules were down low-single digits.

Adjusted operating income was $562 million, or down 19% versus last year. Adjusted operating margins were 20.2%, down 2.4 percentage points year-on-year.

Margin headwinds were driven by lower sales volume, manufacturing and supply chain headwinds … carryover raw material/logistics and energy cost inflation, investments in the business, and impacts from China COVID-related challenges. These headwinds were partially offset by benefits from pricing, aggressive spending discipline, and productivity actions.

Slide 9, Transportation & Electronics
Monish Patolawala

Moving to Transportation and Electronics on slide 9 which posted Q1 adjusted sales of $1.7 billion.

Adjusted organic growth declined 11.3% year-on-year, heavily impacted by a significant decline in demand for consumer electronic devices.

Our auto OEM business increased approximately 6% year-on-year, in-line with global car and light truck builds. We continue to gain penetration on new automotive platforms and expect to outperform build rates over the long run.

Our electronics business saw adjusted organic sales declines in the mid-thirty percent range. This business continues to be impacted by significant end-market weakness along with tiers and OEMs aggressively reducing inventories, particularly for smartphones, tablets, and TVs.

Turning to the rest of Transportation and Electronics … advanced materials had adjusted organic growth of high-single digits year-on-year, while both transportation safety and commercial solutions declined.

Transportation and Electronics delivered $284 million in adjusted operating income, down 36% year-on-year. Adjusted operating margins were 16.7%, down 5.5 percentage points year-on-year.

Margin headwinds were driven by sales volume declines, manufacturing and supply chain headwinds, carryover raw material/logistics and energy cost inflation, investments in the business, and impacts from China COVID-related challenges. These headwinds were partially offset by benefits from pricing, aggressive spending discipline, and productivity actions.

Slide 10, Health Care
Monish Patolawala

Looking at our Health Care business on slide 10 … Q1 sales were $2.0 billion, with organic growth of 1.4% versus last year.

Excluding the impact from the exit of Russia, Health Care grew Q1 organic sales by approximately 2%.

Sales in our medical solutions business and oral care grew low-single digits organically year-on-year, while health information systems was flat due to strained hospital budgets. Separation and purification declined high-single digits due to the normalization of post-COVID-related biopharma demand.

First quarter elective healthcare procedure volumes were approximately 90% of pre-COVID levels as nurse labor shortages and strained hospital budgets continue to impact the pace of recovery. We continue to expect procedure volumes to improve as we progress through the year.

Health Care's first quarter operating income was $360 million, down 19% year-on-year. Operating margins were 17.9%, down 3.0 percentage points.

Year-on-year operating margins were impacted by manufacturing and supply chain headwinds, carryover raw material/logistics and energy cost inflation, and investments in the business. These headwinds were partially offset by benefits from pricing, aggressive spending discipline, and productivity actions.

Slide 11, Consumer
Monish Patolawala

Lastly on slide 11, our Consumer business posted first quarter sales of $1.2 billion.

Organic sales declined 6.8% year-on-year, with particular weakness in the U.S. which was down high-single digits.

Stationery and office grew low-single digits organically year-on-year while the home improvement, and home, health, and auto care businesses declined organically.

Relative to first-quarter last year, consumers have shifted their spending patterns to more non-discretionary items and retailers have aggressively reduced their inventory levels. We expect consumers to remain cautious with their discretionary spending as we move forward through the year.

Consumer's first quarter operating income was $179 million, down 18%compared to last year with operating margins of 15.0%, down 1.8 percentage points year-on-year.

The year-on-year decline in operating margins was driven by lower sales volumes, manufacturing and supply chain headwinds, and carryover raw material/logistics and energy cost inflation. These headwinds were partially offset by benefits from pricing, aggressive spending discipline, and productivity actions.

That concludes our remarks on the first quarter, please turn to slide 13 for a discussion on our outlook for the year and second quarter.

Slide 13, Full-year 2023 guidance remains unchanged
Monish Patolawala

We are maintaining our full-year guidance reflecting a macroeconomic and end-market environment that remains very fluid and uncertain.

Our outlook continues to incorporate the expected second-half improvement in macroeconomic forecasts, including in China. We also anticipate the continued healing of global supply chains which will help support ongoing product cost improvements in our manufacturing and supply chain operations along with working capital performance, particularly inventory reductions.

As a reminder, our full year adjusted organic sales growth is expected to be in the range of (3%) to flat.

This range includes an estimated 2 percentage point headwind from the ongoing decline in disposable respirator demand along with the impact of our exit from Russia.

Adjusted earnings are expected to be in the range of $8.50 to $9.00 per share.

Full year adjusted free cash flow conversion remains forecasted in the range of 90% to 100%.

Turning to our outlook for the second quarter …

First, looking at external macroeconomic forecasts. Both global GDP and IPI are currently expected to improve year-on-year and sequentially.

The softness we experienced in Q1 in consumer electronics and consumer retail is expected to continue into Q2.

We expect both sequential and year-on-year increases in auto builds, while healthcare procedure volumes are anticipated to be similar to Q1 levels, and industrial end-markets are expected to remain mixed.

As discussed, we implemented very aggressive cost controls in the first quarter given the challenging start to the year, including on travel, advertising, external services, and headcount management. While we will remain disciplined, we expect to increase investments as we progress through the year to support end-market demand improvement in the second half and into the future.

Including these factors, our expectations for Q2 are for total adjusted sales to be in the range of $7.7 billion to $7.9 billion versus $8.4 billion last year, or down 6% to 8% year-on-year.

Organic sales is expected to be down low-to-mid single digits, which includes a forecasted year-on-year headwind of approximately 1.5% from disposable respirators.

And finally, foreign currency translation is expected to be approximately a (2%) headwind to sales versus last year's Q2 and divestitures a year-on-year headwind of (1%).

From an EPS perspective, we estimate that second quarter adjusted earnings per share will be in the range of $1.50 to $1.75, including a pre-tax restructuring charge of ($175) million to ($250) million, or ($0.25) to ($0.35) per share.

This range also incorporates:

- The continued softness in organic sales
- an expected increase in investments
- higher non-op interest costs
- and an adjusted tax rate of 18.5% to 19.5%.

To wrap up, 2023 is a pivotal year for 3M from an execution perspective. As I mentioned, we aggressively managed costs, focused on serving customers while navigating end-market weakness, particularly in consumer facing markets, as we started the year.

We expect organic sales volumes will improve as consumer retail and consumer electronics markets stabilize, China works through its COVID-related challenges, and as our year-on-year comps ease.

The actions we announced today will enable us to exit 2023 stronger than we started and provide for significant margin and cash flow improvement into the future.

I want to thank our customers and suppliers for their partnerships, and the 3M employees for their hard work and dedication as they continue delivering for our customers.

That concludes my remarks … we will now take your questions.

Slide 15, Questions & Answers
Andrew Kaplowitz, Citigroup Inc., Research Division - MD and U.S. Industrial Sector Head

Mike or Monish, maybe we could start off by just talking a little bit more about the sales cadence during Q1 and here in April because I think, Monish, you mentioned your Q2 EPS guide is modestly below Q1 even ex restructuring. What happened as Q1 evolved here in April? Have you seen signs of consumer and electronics destocking running its course? I know you classified industrial markets is mixed. Do you see any changes in industrial markets as the quarter evolved? And is it just that increased investment in tax rate holding down Q2 versus Q1?

Monish Patolawala

Yes. Thanks, Andy. So I'll just start again back to 1Q. As we said in the prepared remarks, end markets pretty much played out as anticipated. You had consumer-facing businesses, both our Consumer business and our Electronics business. The Consumer business was down 7%. Electronics was down 35%. China continued to remain soft in Q1. We were down 20% in China. And also the DR and Russia comps pretty much came in where we said. So the end markets played up pretty much as anticipated.

Coming into the quarter, we had given you a guide of $7.4 billion to $7.6 billion. We came in at $7.7 billion. So that's at the high end of our range with some of the benefit also coming from a better FX rate at minus 2.8% versus the 3% to 4% that we had guided coming into the quarter.

So when you look at that and you translate that into 2Q, I would still say the macroeconomic continues to remain fluid and uncertain. We are still seeing consumer weakness both in our Consumer business and in any of our consumer-facing businesses, especially consumer electronics.

And so putting all that into the equation, also looking into industrial markets that remain mixed, healthcare and oral care procedures pretty much remaining flat sequentially. And then auto will be up a little bit sequentially and also up low double digits year-on-year. But then semiconductor is also down mid-teens on a year-over-year basis.

Our current guide is $7.7 billion to $7.9 billion, which then translates to an EPS of $1.50 to $1.75. Included in that, Andy, in that $1.50 to $1.75 is a restructuring charge for the actions that we've announced today of $0.25 to $0.35. So if you exclude that for a moment, then on an apples-to-apples basis, you're looking at $1.85 to $2.

And the delta, if your question is about 1Q versus 2Q is the items you correctly said, which is some more investments as we think -- as we look at the second quarter and the second half and the future, investments that we believe we want to take advantage of the markets as they get better in the second half, continuing to -- but we'll still continue to remain prudent with our investments depending on how the market evolves. And then it's the tax rate and some of the non-op that just sequentially looks tighter.

But with that said, just for the year, again, we are maintaining guidance, which includes the restructuring charge of $700 million to $900 million for the program. We expect half of that will be incurred in 2023. And the benefits from that program are also $700 million to $900 million. And we expect the benefits -- half of those benefits also to show up in 2023.

Just for you to know and for others, we've announced a significant announcement today. Some of them are organizational changes and business combinations -- division combinations. We'll be working through all of the reporting -- our reporting on the new division basis. We plan to do that from 1Q 2024 onwards. Hopefully, that answers your question, Andy.

Andrew Kaplowitz

Yes, Monish. That's helpful. And then, Mike, I wanted to ask you, $700 million to $900 million cost takeout, obviously, a relatively large program. How do you avoid business disruption and/or lower growth given all the changes you're going to make here?

And then assuming the second half of the program does get executed mostly by '24, maybe for Monish, how do we think about 3M's ability to generate that 30% to 40% incremental moving forward? If you do see sales rebound later in '23 as you expect and in '24, for example, should you see unusually high incrementals given the program?

Mike Roman

Yes. Andy, as I said 3 months ago, we've been looking at everything we do as we come through the pandemic, come through the supply chain disruptions even face into the outlook for the year and our markets as we move ahead. So the actions that we've come to, they've been something that we've been very deliberate about thinking through. They're taking from learnings about what worked well and areas that we know we can improve. So it starts with a pretty strong basis. We're confident that these are the right actions about positioning us for growth and profitability as we go forward.

And it'll help us navigate -- as Monish just laid out, help us navigate some of the challenges and uncertainty we have in the current market. So our focus is -- as your question kind of indicated, our focus is on executing successfully. And that's -- these are significant changes. We're confident we've got the right focus. We've made some leadership changes to really ensure that we have our leadership focused on successfully making these improvements.

And I think that this is the next step for us. We believe and we're confident these will be the steps that really help improve our performance in our businesses and our supply chain. And as the second part of your question focused on, it's about improving our costs and margins. Reducing our costs and improving our margin performance gives us a position to be successful in the future, leverage our innovation to create differentiated value with customers and deliver that to the bottom line performance that we expect both in terms of margins and cash flow.

So it does position us for confidence in being able to do that as we go forward that incremental margin from our differentiated innovation. So yes, that's -- it's exactly the reason and confident we're positioned at the right -- with the right strategies in place.

Stephen Tusa, JPMorgan Chase & Co, Research Division – MD

So just on this restructuring cost, can you maybe just give us a quarterly cadence on the costs and then the savings? And I mean getting half of the savings this year, that seems like a pretty quick payback on half the spending. Like is there anything unique to this program that would have an accelerated payback like that? It seems like a one-for-one on a quarterly basis, which is pretty fast.

Monish Patolawala

Yes. So I'll just start again, Steve. It's $700 million to $900 million. We expect half of that to be incurred in 2023 and $175 million to 250 million to be incurred in the second quarter. The benefits of that program is also half in 2023, very little in 2Q. So the benefits actually show up in the second half.

The reason the benefits are stronger than you would have normally seen as not all of these costs are just people-related costs. We are taking a lot of other costs out from the center of the company, we're reducing rooftops, et cetera, which allow us to exit some of these cost structures faster, and that's why you get a better payback.

Stephen Tusa

And so as far as the cadence of the charges, is there -- is it -- should we assume that they're spread throughout 3Q and 4Q and additionally with the savings, 3Q and 4Q?

Monish Patolawala

Right now, I would just focus on 2Q and the total year. And we'll update you, Steve, as we get through the announcements today and work through all the people-related costs and work through the rules and regulations in various countries. I would just focus on total year-end and 2Q.

Stephen Tusa

Okay. And then what was -- as far as like the go-to-markets are concerned and how you're changing things, what was the catalyst for this? What did you see in the business that you thought you needed to improve on from a go-to-market perspective with all these changes that you were talking about? It seems like some pretty significant initiatives from that perspective and a change in the way you guys have done business historically. What was the catalyst for that? What did you see that you didn't like?

Mike Roman

Yes. I think the catalyst is really the learning and experience that we've gone through over the last few years. We put in place a business-led model really around our go-to-market models. We also put in place a global supply chain model that was end-to-end managed in one consistent model across the world. And we've been operating that through the pandemic, through the supply chain disruptions.

Our businesses are learning, the go-to-market models that we have in place, we're learning how to optimize those. And I would say we're -- we've gotten to a point when we look at where our markets are going in the future, where we want to invest, how we want to operate best to serve our customers. It's really a learning -- more of a learning over that experience than a catalyst.

There's a catalyst, that's to position ourselves as we take action now for the future, make sure that we are stepping into the changes that will both drive the performance in the near term and also position us for the future. So the learning was really -- and I think the clear view of what we can do to improve in the go-to-market models and also in our supply chain that is really, like I said, giving us the strong focus on the actions that we're taking and announcing today.

Monish Patolawala

Can I just add one more, Steve? As I've always said this before, digital is a multiplier for 3M. And some of the digital capabilities that we have built over the last few years allows us to serve customers better. For example, Mike mentioned one of the areas where we are relooking at how we go to market in certain countries where in the past, we have had a full roof's top and a full cost structure, and now we're going to work through our partnerships of third-party distributors, leverage our digital capabilities, leverage our export capabilities. And that also allows us to reduce cost while making sure we still continue to take care of customers in those countries.

Scott Davis, Melius Research LLC - Founding Partner, Chairman, CEO & Research Analyst of Multi-Industry Research

We've got a couple of different -- I mean this restructuring is large as the fellows have said. But you're also going to be getting out of the PFAS manufacturing business. Is that included in the restructuring? Or there'll be separate actions kind of sequentially on top of that as you exit each of these things?

Mike Roman

Yes, Scott. The PFAS exit, I would say this, we are executing what we announced at the end of last year and working to discontinue the use of PFAS in our products and working to exit the manufacturing. It's not a specific focus in the restructuring actions. That's -- we've got a dedicated team following through on that set of actions, and we continue to make good progress. We're working closely with customers and, I would say, making progress on our innovation to discontinue the use of PFAS in our products across the company. So it's a separate focus, separate team and a separate strategy for us.

Monish Patolawala

Just to reminder, Scott, from a numbers perspective, when we announced the exit of -- the intent to exit our PFAS manufacturing and reduce our use of PFAS in our products, we had announced a fourth quarter charge. We said the total program would cost us $1.3 billion to $2.3 billion. In the fourth quarter of last year, we took a charge of $800 million, which was largely noncash. We continue to make progress around that. Our current excluded numbers include what that -- the extra charge in the quarter. For a total program basis, we still expect to incur right now $1.3 billion to $2.3 billion.

Scott Davis

Okay. And Mike, I wanted to just ask you on R&D productivity. I mean when you think about the investments that you guys have made over the last 50 years, whatever, there's been time periods where growth has been great and a lot of support on the margins. And then there's been, perhaps the last decade, where I'd characterize growth is pretty minimal and maybe not as much supported in the margin structure as you had in the past.

But is part of the restructuring and the changes you're making to help drive more accountability and productivity in R&D? Is it -- is there a -- I mean, I guess, a more polite way to ask the question is, is there any cultural or structural problems in R&D that you can address and perhaps improve that productivity going forward?

Mike Roman

Yes, Scott. I think it's an important part of the actions we're announcing today, I would say, is to position us to be successful in delivering on the differentiated value that is 3M innovation. And we are always innovating around how we do that.

We -- I talked about in the announcements today that we are prioritizing some large, high-growth market segments where we have strong commercial presence and we can leverage strong innovation. So I think if there's a kind of a consistent message over the last year or so from me is that we are prioritizing more and more where we focus that R&D investment. It's still the first priority in our capital allocation, invest in R&D, invest in CapEx to drive that growth. We see the opportunities in those high-growth market space.

We also called out and we're -- as part of our actions that we're announcing today, we're putting in place a central group to really focus some of the capabilities that we have in broad material science going after some emerging market segments like climate tech and industrial automation, sustainable packaging. Next-generation electronics has got over the horizon some really exciting spaces.

So it's about continuing to evolve that prioritization. And the businesses, they've got, I would say, a very clear focus on where their priority markets are, where their customer opportunities are that they can really create the most differentiation.

So that's the, I would say, a continuous innovation and evolving nature of how we think about investing in R&D, how we think about driving growth. And our goal remains the same: to leverage our innovation, to grow at or above the macro of the economies that we're part of and really focusing on those high-growth market segments so that we can do that.

Christopher Snyder, UBS Investment Bank, Research Division - Analyst

I wanted to ask on China. I think you guys called out China down 20% in the quarter. Was that worse than you guys have anticipated? And it sounds like there's an expectation of China stabilization or improvement as the year goes on? Is there anything you're seeing here through April maybe that gives you confidence that things there are getting better?

Monish Patolawala

Yes. So Chris, we did call out down 20%. It's pretty much played out exactly where we expected it to be when we gave you the first quarter guide. And in the second quarter, currently, we are expecting China to be down low single digits to mid-single digits. But sequentially, a few days into April, it's pretty much playing out where we saw.

And just talking to customers, talking and looking at all the external factors, there is an expectation that China GDP grows -- increases in the second half sequentially and year-on-year. And our full year guidance, as I've talked about, assumes overall recovery in all economies in the second half, including China. And as supply chains continue to heal, we should start also seeing the productivity or cost reductions in our cost of goods to start showing up in the second half.

And so sitting right now, that's how we see China. China was impacted heavily by consumer electronics down in the first quarter, and that's also reflected in our results.

Christopher Snyder

And then for my follow-up, I wanted to ask on the destocking that you're seeing at the customer level. I think you guys called out retail as destocking year-to-date, and then we've seen the same in the data. Can you maybe just talk about where you think the supply chain is in that destock cycle?

Mike Roman

Yes. Chris, we talked a bit about the consumer retail destocking as we came into the year, and we saw that play out in Q1. There -- I would say, in the U.S., in particular, retail has been destocking in the discretionary categories. And we saw that, and that was part of our expectation and pretty much played out as expected.

We see that getting back to closer to your more consistent weeks of stock, but there's still probably some destocking to continue there, not maybe as aggressively as we saw in Q1, but we still see that playing out as we move ahead. We're also seeing destocking, I would say, across some of the industrial markets. So we talked about that back on our Q4 earnings call as well that it was maybe out of cautious view of the outlook, and I would say that has played out as expected.

We saw destocking in China around the slowdown in electronics. Also, in automotive, we -- China saw a slowdown in automotive builds in Q1 and Asia more broadly destocking around electronics. I think the automotive levels more broadly given the growth are relatively in balance, maybe even low in some areas.

Health Care is pretty well aligned with the market and the recovery that we're seeing in procedures. I think the consumer is also seeing the dynamic of seasonal builds. There are some seasonal builds going on in the channel as well. So some destocking, which played out as expected in the first quarter, I would say some of it carrying into the second quarter as we go forward. And then when you see the downturn in demand in electronics, there's naturally some destocking in the channels related to electronics as well.

Joshua Pokrzywinski, Morgan Stanley, Research Division - Equity Analyst

I just want to follow up on the restructuring program. Mike, Monish, I think you guys have had a few programs now over the last several years. And I know that they're approaching different aspects of the cost elements and different regions, et cetera. But trying to roll up to where do you see the margin entitlement for the business as we get through these programs over the next several years. Is there anything that you sort of have pencil out there that we should keep in mind, especially with a few of these programs overlapping and different mix changes, et cetera, going on within the business?

Monish Patolawala

Yes, Josh. So I would say a couple of things. One is, of course, we have to have these programs work through. As we said, it's $700 million to $900 million. A large piece of those charges will be completed by 2024. So you'd start seeing the benefit without these charges in 2025 and beyond. That time, of course, you had to think through what the revenue is.

But if you just use 2023 as a guide, as a basis, the margin expansion, excluding these charges are when these charges are done, is a 200 to 300 basis points of margin expansion that you should see on an annualized steady-state basis. What I would tell you is that allows us to definitely get the better leverage that we have all been talking about.

But the second other factor that comes into play as supply chains start to heal, you should start seeing productivity and cost out starting to show up, which again is in our second half guide for the year. But that should continue into the future years. And then you add on data, data analytics and the digital capabilities that we have, that will allow us to do better network and logistics optimization, also dual-sourcing programs kicking in, et cetera. So we should continue to see margin rates expand into the long term once these programs are done. So hopefully, I answered your question, Josh.

Joshua Pokrzywinski

Yes. That's helpful. And I'll leave it there at the interest of time.

Joseph Ritchie, Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst

So I know we've had a bunch of questions on the restructuring. I want to delve in a little bit deeper there because there's lots of cost levers that you described. I'm just curious, is there a way to bucket perhaps like some of these -- how big, like whether it's reducing the layers or supply chain is in that $700 million to $900 million cost-out?

And then maybe specifically on the simplification piece, again, any kind of quantification, like how many P&Ls are you streamlining? Any other color around that would be helpful.

Monish Patolawala

So Joe, the $700 million to $900 million, if we just break it down to broad buckets, 40% of it is around the supply chain simplification that Mike talked about. The remaining 60%, you can split between costs at the center of the company and costs at the BGs.

From a P&L perspective, a couple of items that Mike talked about, again, on the go-to-market. There'll be a couple of divisions in TEBG that will be combined. And then from a consumer perspective, we will serve our customers more from an area perspective and then realign them around portfolios.

And the other piece on a go-to-market cost saving is, as we look at some of the countries, the way we serve using our digital capabilities, we will look at using our partnerships that we have with our third-party distributors in those countries and use a digital/export model to serve those customers in those countries, which will also allow us to take out rooftops and fully loaded P&Ls in those countries that will also allow us to save cost.

Joseph Ritchie

Got it. That's super helpful. And maybe my follow-on question, I didn't hear it earlier, but how much pricing came through this quarter? What's the expectation going forward on price/cost?

Monish Patolawala

Yes. So depending on the business group, Joe, we had anywhere between low to mid-single digits. The average is low single digits. The guide for the year is low single digits. And at the same time, as we have said before, if we continue to see inflation, we will readjust as needed.

The teams have done a good job, I would say, of looking at it product by product, market by market and making the right necessary price moves as required when they see inflation.

Julian Mitchell, Barclays Bank PLC, Research Division - Research Analyst

Maybe leave aside the firm-wide restructuring for a second. And I just wanted to focus on the Health Care business as that's meant to spin out in a matter of months. The margin is down pretty heavily year-on-year again, down sequentially as well and not a lot of organic growth. So just trying to sort of understand how comfortable do you feel with that Health Care business kind of ahead of the spin?

Are we seeing a big front-loading of investments, so it has kind of less to do post-spin? Just trying to understand kind of the approach there for this year and why those margins seem to be under such pressure.

Mike Roman

Yes. Julian, and I'll come to kind of the organic growth and margin. I would say we continue to see the healthcare procedures as an important driver of our Health Care performance. And there, we see some improvements. Monish highlighted in his prepared remarks some of the headwinds and challenges that are still -- the labor shortages and some of the challenges in health care recovering to pre-pandemic levels.

So that's important factor in driving our growth. If you look at our business, we also had some headwinds from the Russia exit and DR and so close to 2% organic growth. And we expect as procedures do recover that we'll see improvements in our organic growth.

On the margin side, Monish called out some of the headwinds, we have -- still seeing some supply chain headwinds, still seeing some carryover from material raw material and logistic inflation, energy cost inflation. And we are making some investments, investing in -- it is a prioritized area of growth for us, and we're making and really staying focused on those investments. So it's a -- it is part of the performance in the quarter. But again, confident that as procedures improve, we'll see growth and growth gives us the best leverage to the margin. We'll see those margins improve as we see some of the supply chain healing and some of the actions that we are taking help impact that as well.

Monish Patolawala

Just one more to add is biopharma. As we mentioned in our prepared remarks, biopharma this quarter was also impacted due to the normalization of COVID-related demand. And as Mike mentioned, the Health Care business is -- for us is a great business. We will see volumes grow as elective procedures grow, oral care procedures go and biopharma demand comes back once we get the normalization out of the way from an inventory level.

And with all that put together, the margin rates will also go up as volumes come through. But this is, again, a segment Mike has called out multiple times an area where we see great opportunity, which means we will continue to invest in that segment to make sure we take advantage of long-term growth.

Julian Mitchell

And then just my follow-up on electronics specifically. I think you mentioned, Monish, that was down sort of 35% in Q1 year-on-year. It looks like the second quarter is down maybe in the teens based on Slide 13 in Electronics. How are you thinking about that sort of rate of improvement? What's baked into the back half for Electronics in your guidance? Do you think we should see year-on-year growth by the fourth quarter for Electronics? Any sort of color there around how you're looking at that business through the balance of the year?

Monish Patolawala

Yes. That's -- you got it right. Right now, our second quarter is also going to get impacted continuing inventory challenges and destocking at consumer electronics, whether it's tablets, notebooks, TVs. Our view is that as China stabilizes as we start seeing our comps ease compared to last year, fourth quarter should be on a much more normal run rate, which means on a year-over-year basis, it will show positive growth.

Nigel Coe, Wolfe Research, LLC - MD & Senior Research Analyst

So just wanted to touch on the appointment of Mike Vale as Group President. Just first of all, congratulations to Mike. But how does this change your role, Michael Roman, in terms of your focus areas? I mean Mike is obviously -- seems like he's getting direct responsibility for the 3 segments. I mean how does this change your focus areas going forward?

Mike Roman

Yes. Nigel, I think it's a reflection on really what are the strategies and actions that we're driving and the priorities that we're focused on right now and the importance of having leadership that brings the necessary focus as we go forward. And so it's even looking back to 2022, the -- some of the pivotal actions that we announced as we came through the year, they are the health care spend, our actions in terms of our supply chain changes, focusing our leadership now with the actions we're announcing today to go further and really make the changes in our -- the next set of changes in our supply chain, moving forward with our new go-to-market models.

Mike's role is really focused on that. When I talked to Mike about stepping into this leadership role, it's about really ensuring success as we drive these actions and changes forward, position us for the future, help the businesses working with the supply chain to be successful in integrating these changes and building for the future, help us to focus on the high-growth market segment.

So it's really about putting up -- taking our priorities and putting a strong leadership support in place to drive that. These are important and really significant actions that we're putting in place and important that we have. We also are supporting our leadership with a dedicated project management office. These are significant changes. So it's really a strong statement about what's most important both on the restructuring but also on our strategies in terms of growth and executing for our customers.

Nigel Coe

Okay. That's helpful. And then one for Monish, just a follow-up on Joe's question on pricing. It seems like given the 1.3 percentage points hit to margins from raw materials, it seems like price/cost was positive this quarter. Just wondering if there had been any change in the way you're viewing the supply chains to raw material kind of dynamics for this year.

Monish Patolawala

Yes, no change. I would say it's the same. So price/cost was positive, and the teams continue to manage both. As we think about the second half, that's where supply chains, our belief is supply chain start healing, which means we should be able to see better cost -- product cost from our factories as well as the cost from sourcing. That should continue to help us build on margins, which goes back to where -- what we have talked about at earnings, talked about it at last quarter earnings, currently too, that all of this is baked into our guide where we see supply chain starting to heal in the second half and even markets starting to heal in the second half because as you know, we've talked about volume gives us the best leverage. So those are the 2 things we're counting on in the second half.

Deane Dray, RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst

Can we get an update on the health care Analyst meeting? And what's the effect on the separation of R&D? There's so much in way of shared technologies. What's the plan there and also for stranded costs?

Mike Roman

Yes. Deane, maybe I'll make a comment about the R&D. So this is something that we've managed with other separations and divestitures and nothing of the health care spend scale, but it's something that we're able to manage. We've -- part of the focus of the separation team is on this area, and it's important to be able to set up both Health Care and 3M going forward with the strong foundation for innovation that they both need.

And you -- the fields of use are actually quite distinct between Health Care and what will be 3M Company going forward. So that's a really a big part of it. And then we work through the details, make sure that we are positioning both companies to have the -- not only the access to the technology, but the intellectual property that is at the foundation of what makes our innovation really that differentiated. So making good progress on that and feel like that's an area that we have a good road map ahead for us to follow.

Monish Patolawala

Just on your second question on timing. As you know, Deane, last quarter 2, Mike had said, the teams are continuing to make good progress. This quarter 2, they're making good progress. We were going -- we were working towards a Q4 '23, early 2024 time line. But just a reminder, our spin timing ultimately is subject to the IRS rulings because we want this to be a tax-free transaction, government approvals, making sure we get final Board approval and also taking into account other conditions like equity and debt markets, other external conditions that could impact -- on other developments that could impact 3M or any of its business.

So put all that together, I would just say that teams are focused, dedicated teams continuing to make progress working through all the government regulations that we have to work through to get ready.

Deane Dray

That's helpful. And just if you can comment on the plan for stranded costs. And are there other spin-offs being contemplated by the Board?

Monish Patolawala

So I'll just -- on stranded costs, when we announced this transaction mid last year, one of the items we had talked about was that benchmarks were anywhere between 1% to 1.5% of revenue is stranded cost. And we had talked about saying, we believe we can do much better than that. Based on all the actions that we are taking today, currently, our view on stranded costs ultimately depends on the revenue of ParentCo is between 50 to 75 basis points, so much lower than benchmark. But we'll keep working it. We'll keep working it from now until the end of the -- til the spin-off. And we'll keep working it post that, too, to reduce that.

Mike Roman

And Deane, I would say we're focused on successfully moving forward and making -- successfully making progress with the spin of Health Care. And we are, of course, focused on the actions that we announced today. So we don't plan on any other major portfolio actions in the near term.

Nicole DeBlase, Deutsche Bank AG, Research Division - Director & Lead Analyst

In the interest of time, I'm just going to ask one, and that's -- can you just comment on how organic growth kind of trended throughout the quarter, if there were any discernible differences between Jan, Feb, March and then into April?

Monish Patolawala

So Nicole, I would say overall, the quarter pretty much played out as we thought. Jan, Feb, March, we expected acceleration, which we saw. April is also playing out pretty much where we saw. So there's -- I would say there was nothing in the intra-quarter trends in Q1 that stood out from where we had expected it to be.

China remains soft, consumer-facing businesses remains soft, industrial end markets ex electronics remain strong. And then healthcare elective procedures pretty much remain the same. And you normally in that industry see a Q4, Q2 or 1Q slowdown just as procedures slow down, and we saw that too. So nothing I would say is major to call out intra-quarter in 1Q.

Mike Roman

To wrap up, we are taking significant actions to create a streamlined and stronger 3M. We will stay focused on creating greater value for customers and shareholders, improving our performance and using 3M science to make a difference in the world. Thank you for joining us.