Q4 2024 Earnings Call Transcript
Bill Brown and Anurag Maheshwari
January 21, 2025

Slide 1, Cover page
Chinmay Trivedi, Senior Vice President, Investor Relations and Financial Planning & Analysis

Thank you and good morning, everyone, and welcome to the fourth-quarter earnings conference call.

With me today are Bill Brown, 3M's chief executive officer and Anurag Maheshwari, our chief financial officer. Bill and Anurag 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.

Slide 2, Forward-looking statements
Chinmay Trivedi

Please turn to slide 2 and take a moment to read the forward-looking statements. 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-Q 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 hand the call off to Bill.

Bill …

Slide 3, Strong execution in Q4, capping a solid year
Bill Brown, Chief Executive Officer

Thank you, Chinmay, and good morning, everyone. Before I start, I'd like to welcome Chinmay to his first earnings call as the Head of Investor Relations. He's been with 3M for 3 years leading the FP&A function and was with GE before joining 3M. He's replacing Bruce Jermeland who retired on January 1st. Bruce led IR for the last 6 years and was with 3M for more than two decades, and we wish him well in his retirement.

2024 was a pivotal year for 3M. Earlier in the year, we spun-off our Health Care Business Group as Solventum and we settled two significant legal matters. We also substantially completed the largest restructuring program in company history, which focused on reducing complexity and improving margins. These changes weren't easy, but the team has done a terrific job executing the programs and the results are showing up in our financial performance.

This relentless focus on operational execution drove a strong finish to the year. Fourth quarter adjusted earnings per share was $1.68 on 2.1% organic revenue growth. The company generated free cash flow of $1.3 billion with conversion of 145%. During the quarter we returned $1.1 billion to shareholders via dividends and share repurchases.

These results capped a strong year for the company where we delivered $7.30 in adjusted earnings per share, at the high end our guidance and up 21% YoY. Organic sales grew 1.2% and we generated $4.9 billion in free cash flow with a conversion rate of 111%.

Slide 4, Advancing our top priorities
Bill Brown

Turning to slide four, the fourth quarter results reflect our focus on the fundamentals. Each business group drove positive adjusted organic growth -- the first time in 9 quarters that all business groups grew together, and it was broad based. 12 of our 16 divisions posted positive growth compared to only 7 in the first quarter.

One of the "fundamentals" is commercial execution, and we're beginning to make progress in this area. For example, in Safety & Industrial we launched a campaign to drive cross-selling at our channel partners with some encouraging early results. And this year, we pulled forward the quota-setting process for our salesforce to ensure we get out of the gates quickly, and we instituted standard work for our sales managers and area leaders who support our frontline sales reps.

Reinvigorating the innovation engine is critical to sustain this top line momentum. In 2024 we launched 169 new products, up 32% over the prior year. This was above expectations due in part to the rigor and governance we have put in place around new product introductions, but more importantly to the enthusiasm of the team to get back to innovating for our customers. One launch we're particularly excited about is our LCD 2.0 platform program that enables LCD displays for tablets, notebooks and monitors to achieve the brightness and contrast similar to OLED, combining our multilayer optical film technology with our microreplication technology. Another one is our expanded beam optics – or EBO – connector which is an optical interconnect designed for data centers that reduces installation time, cleaning and maintenance while delivering exceptional performance.

But we're still in the early days of our R&D turnaround effort. NPI is clearly an important metric, and in 2025 we expect to see a double-digit increase in the number of launches on top of the higher performance in '24, but it's just one of several we're tracking. Over time, we need to work to shorten the development cycle time to increase launch cadence, focus investment dollars on higher octane programs, and see NPI translate into higher sales and margins.

Also critical to driving growth is improving service, and a key metric for us is on-time-in-full, or OTIF. OTIF was 88% for the year, up 3 percentage points versus last year and 8 points versus 2022. Our team has made solid progress, but we have more work to do. While Consumer and Transportation and Electronics are now consistently delivering to their customers at over 90% on-time, our performance in Safety and Industrial remains well-below expectations in the low 80's. It will take a fundamental shift in our approach to raise services levels to where they need to be, and we're doing this by standardizing the demand planning process, using new algorithms to improve forecast accuracy, improving supplier delivery performance and driving consistency and reliability in logistics.

These are key elements of our broader operational excellence program, which continues to mature but is still in the early innings. Our goal remains to deliver 2% net productivity through sourcing efficiency, quality improvement, lean manufacturing and asset utilization, which I described last time as operating equipment efficiency, or OEE. These efforts are starting to take hold and will support further gross margin expansion toward our goal of high 40's.

We also made progress on inventory days, which was down 2 days versus last year and 8 sequentially, ending the year at 94 days. This is just a start as our goal is to get to 75 days, freeing up cash for our capital deployment priorities – which include returning cash to shareholders. Last year, we returned $3.8 billion to shareholders -- $2 billion in dividends and $1.8 billion in share repurchases.

Lastly, we continue to assess our portfolio, and we have several small actions underway. We'll update you on progress as deals are signed.

Slide 5, Our 2025 outlook
Bill Brown

Moving to guidance on slide five, our strong finish in the fourth quarter gives us confidence in our ability to deliver in 2025. For the year we expect organic sales growth in the range of 2% to 3%, adjusted earnings per share in the range of $7.60 to $7.90 and free cash flow conversion of approximately 100%.

Our back-to-basics approach and focus on our three top priorities underpins our ability to deliver on these commitments as the macro recovery continues to be uneven. Currently IPI is forecasted to be 1.9% in 2025, but as you may recall the forecast for IPI in 2024 twelve months ago was also ~2% and we ended the year at ~1%. We'll see how that evolves but we'll be looking to take advantage of this acceleration as it materializes.

Other key data points to watch include auto builds which are expected to be slightly negative but down 3% to 4% in Europe and the US, where we have better penetration, and flat in China and up across Asia where our content per vehicle is lower. Consumer electronics is expected to be up LSD-MSD, and consumer discretionary spend remains soft, especially in the US where retail sales are expected to be relatively flat.

As we navigate the ups and downs of the macro environment, we'll focus as always on what we can control:

- Servicing our customers at higher levels,
- improving commercial excellence at the customer interface,
- filling up the innovation pipeline to support future growth, and
- driving productivity and efficiency throughout the organization.

We look forward to sharing more details on each of these priorities as well as our medium-term outlook during our investor day in St. Paul on February 26th. You'll hear from our leaders in R&D, supply chain, and the business groups about their execution plans that will turn our priorities into results. I hope to see you there.

With that I'll turn it over to Anurag to walk through the details of quarter.

Anurag…

Slide 6, Q4 2024 performance
Anurag Maheshwari, Executive Vice President and Chief Financial Officer

Thank you, Bill.

Turning to Slide 6, we had a strong finish to the year with Q4 performance coming in better than expected. Total adjusted sales were $5.8 billion with organic growth up 2.1%. All three business groups had positive adjusted organic growth in the quarter and performed better than our end-markets.

In the fourth quarter, global IPI was up 1.4% year-on-year and the markets we serve trended in-line with expectations … Consumer electronics remained stable, automotive OEM builds were flat, and consumer retail discretionary spending was soft.

Geographically, our growth was led by China, up high-single digits driven by our electronics business where we continue to gain share and saw modest front loading from an anticipated change in tariffs. The U.S. was up low-single digits despite the challenging macro backdrop with growth in aerospace and general industrial. And EMEA was down low-single digits due to the continued weak environment including a high-single digit decline in auto builds.

Adjusted operating margins were 19.7% down 20 basis points year-over-year and adjusted EPS was $1.68 or 5 cents better than the midpoint of our guidance. The better performance was driven by 9 cents of volume leverage, higher productivity, and lower restructuring charges more than offsetting the unexpected 4 cent headwind from FX due to the significant recent US dollar strength.

I will provide a quick overview of our growth performance for each business group on Slide 7.

Slide 7, Q4 and Full-Year 2024 sales by business group
Anurag Maheshwari

Safety and Industrial organic sales grew for the third consecutive quarter with 2.4% growth in the fourth quarter.

This growth was broad based with 6 out of 7 divisions posting positive growth. We saw particularly strong demand for e-bonding in electronics and hearing and body protection in personal safety. In addition, growth was driven from a few large power grid orders as anticipated in Asia and the US for aluminum high-capacity conductors, and power cable accessories for data centers.

For the year, safety and industrial sales were approximately $11 billion dollars with organic sales growth of 0.7%, led by strength in e-bonding, cable accessories, and auto body repair. Roofing granules had another year of mid-single digit growth as we continue to capitalize on the multi-year roof replacement cycle.

Transportation and Electronics adjusted sales were up 2.0% organically in the fourth quarter.

The consumer electronics business showed continued strength, growing high single-digits driven by solid volumes through the holiday season and continued share gains. Aerospace was again up double digits in the quarter, while the auto OEM business was down mid-single digits reflecting continued weakness in global car and light truck builds.

For the year Transportation & Electronics had adjusted organic growth of 3.4% driven by electronics, aerospace and auto.

Our electronics sales were up ~12% from strong market demand combined with new product introductions and spec-wins that drove share gains. Despite a challenging Q4, our auto OEM business was up 2% versus a 1% decline in auto build rates. And the aerospace business grew double digits again for the year and 50% over the past two years, reflecting our focus on growth portfolios.

Finally, the Consumer business returned to growth in the fourth quarter up 1.2% organically.

Home improvement led the way up low-single digits driven by strength during the holiday season for Command, Scotch tape and paint protection products.

And for the year our Consumer business was down 1.2% with low single digit growth in home improvement sales, mainly Command, more than offset by low to mid-single digit declines in the other divisions.

Let me summarize our full year 2024 financial performance on slide 8.

Slide 8, Full-Year 2024 performance
Anurag Maheshwari

On the back of strong fourth quarter performance, we finished the year with total adjusted sales of $23.6 billion dollars and organic growth up 1.2%.

All of our business groups were in line with our guidance, and from a geographic perspective, we saw solid organic growth in Asia Pacific up 4.4% driven by consistent strength in our electronics business. In the U.S, despite IPI being down 0.3%, our business was up 0.7% driven by electrical markets, aerospace, cable accessories and home improvement. EMEA was down 1.3% due to the decline in auto builds and the weak industrial and manufacturing environment.

Our adjusted operating margins expanded 280 basis points, above the high end of our guidance range of 250-275 basis points, to 21.4%. This performance was driven by benefits from volume leverage, productivity, Solventum Transition Service Agreement cost reimbursements, and restructuring, partially offset by FX and investments to drive growth in the business.

We delivered $7.30 of EPS for the year, up 21% and at the high-end of our guidance range. Over 80% of our year-on-year performance was driven by strong operational execution.

Finally, we delivered free cash flow of $4.9 billion or 111% conversion which included net working capital improvement of 8 days and returned $3.8 billion to shareholders in 2024.

Please turn to slide 9 as we look into our 2025 guidance.

Slide 9, 2025 guidance components
Anurag Maheshwari

As Bill indicated, we expect organic sales growth of 2% to 3%, earnings per share of $7.60 to $7.90 representing growth of 4% to 8%, and free cash flow conversion of approximately 100% - all on an adjusted basis.

We expect all Business Groups to grow low single digits which is in line with or above macro. We expect this higher growth trajectory to be supported by our focus on commercial excellence, improvement in service levels, and new product launches. We have largely moved past product portfolio prioritization headwinds and the small amount that remains is incorporated into our guidance and won’t be specifically called out going forward.

Our EPS growth is anchored by margin expansion in a range of 130-190 basis points which reflects our relentless focus on operational excellence.

Adjusted free cash flow conversion is expected to be approximately 100% driven by strong operating income growth and a focus on working capital management. Adjusted capex of approximately $1 billion dollars will be in line with depreciation and amortization.

Slide 10, 2025 adjusted EPS guidance drivers
Anurag Maheshwari

Let me take a minute to walk through the EPS drivers for 2025 on Slide 10. We expect EPS growth of 4% to 8% driven by operational performance that is partially offset by non-operational headwinds. We are confident that our focus on operational excellence will contribute 70 cents to one dollar or 10% to 14% to adjusted EPS growth. This growth will come from volume, restructuring and net productivity more than offsetting growth investments and stranded costs.

We expect non-op headwinds of approximately 40 cents, half from FX due to recent strengthening of the US dollar and the other half from below the line items, including pension expense, net interest, and tax, partially offset by share buyback. We plan for our gross share repurchase program in ‘25 to be ~$1.5 billion dollars.

Putting all this together, we expect strong operating performance and capital deployment to drive EPS growth.

As we think about the cadence through the year, we expect sales and EPS to be split equally between the first and second half in line with historical trends. Within the first half, we expect Q1 sales growth to be similar to Q4 and earnings will reflect the annual equity grants which last year were deferred to Q2. This will result in Q1 earnings being similar to that of last year and we expect sequential improvement into Q2 as we lap the Solventum spin items, with earnings being approximately equal between the two halves.

I want to take a moment to thank the 3M team for the strong finish to the year and am confident in our ability to deliver another strong year in 2025 with growth acceleration, strong margin expansion and return cash to our shareholders in excess of $3 billion.

With that, let’s open the call for questions.

Slide 11, Q&A
Jeff Sprague - Vertical Research Partners – Analyst

Just on the top line in particular. So I was wondering if you could give us a sense of to what degree the operational execution, product development has actually impacted the top line already versus what you expect to play out in 2025, just thinking of some of these product launches and the like came later in the year. So perhaps we could start there.

Bill Brown

Thanks for the question. Yeah, we are very pleased with the acceleration. New product introductions, as I mentioned in my remarks, came in above expectations -- in fact, quite a bit above expectations. But it's still very early. A lot of the products that we're launching are what we call class three, so they're incremental. So year one sales on these products are going to be somewhat light, and it will grow over time over the next several years. More importantly, as we grow our NPI launches next year by double digit, we shift to more what I call higher-octane or class four-type products, which have more sales capability. We'd likely see more impact on the top line from these launches.

It's an important dimension. I think the team has built momentum. It's part of the governance process. It's a lot of -- it's the enthusiasm of the team. Some of it is shifting some resources around. We added 50 people in Q4, and we moved about another 100 people into R&D development in the quarter. So we're on the right track. There's a good sign. We've got to see it turn into reasonable and substantial margin and income over time. But whatever we've seen in terms of the launches is built into the two to three guidance we see next year.

Jeff Sprague

Great. And then maybe just one for Anurag. A lot of conversation last year as we were all trying to fine-tune our models on the restructuring versus stranded costs and the like. Just wonder, within that $0.70 to $1 bridge item, Anurag, if you can give us a little bit of granularity on restructuring investments and stranded costs, in particular.

Anurag Maheshwari

Sure, let me do that. And probably, what I'll do is I'll break the pieces to the bridge. So at the midpoint of our EPS guidance, we are growing 10% to 14%, excluding the non-op items, which is quite strong relative to the midpoint of organic growth. So there are three factors for that. One of them is sales volume, which creates significant volume leverage as well as incrementals. So a 2.5% volume growth at the midpoint of the guidance and 35% incrementals, that's about $200 million or so. Second is the lower restructuring cost, to your specific question. And that's about a $200 million tailwind into '25. So that's another $200 million. And finally, on the net productivity, that's about $150 million as well, and lots of pieces in that. The PFAS stranded cost is a negative $100 million. We're making some growth investments as well, but offsetting that is overall net productivity through the factories, through our SG&A function as well.

So we put all the three buckets together, it's about $550 million of margin improvement. FX is offsetting about $125 million of that. So the $425 million is at about -- at the midpoint of our 160 basis points of margin expansion. So those are the three big pieces driving the operational growth of $0.70 to $1.

Scott Davis - Melius Research – Analyst

Bill, you mentioned the quota pull forward. I think you mentioned something about some changes in the sales organization. But if we just back up a little bit, what -- perhaps you could just frame what you're trying to change with the sales organization and maybe a little bit more detail and what exactly does that mean when you talk about a quota pull forward for -- as far as trying to drive growth.

Bill Brown

Yeah. So it's a great question. Thank you for that. When I laid out the original plan around driving top-line growth, the basis is around driving more innovation. And that's going to take time, and I commented on that a little while before. Growth in the near term is going to come from selling more of what we have on the market today. And that's an important dimension to this, which is just a more aggressiveness in our front-line sales and marketing resources. They're dealing right now with not a lot of new things to say to the customers because we haven't been innovating as much. And our on-time-in-full performance out of the factories has not been that great. It's improving, but it has not been that great. So the salesforce is challenged in some ways to sell, and I think they've been on their feet in some ways. And I think what Chris and the team at SIBG and others across the company are doing is really leaning into this.

So what we're trying to push for is making sure that the sales leaders, the sales reps out in the field, they know what they're expected to do in 2025 early in the year. So that's -- they're getting out of gates, January 1, with their quota, their target, specific things around closed wins. Typically, that would have been in early April when it rolls out, so a little bit lagged. So that's why Q1 might not have had some momentum. A little more structure around how the sales managers and area leaders are working in terms of their cadence, reviewing progress with their sales reps, that's quite important.

Some of the other dimensions that we're pushing on here is around cross-selling. We -- it's a pilot. It's six combination pairs that we've done, six or eight different distributors. So it's small pieces here. But in December, we saw some pretty good momentum building. And I'm pretty optimistic that over this year and next that there's going to be some benefits for cross-selling.

We're working on pricing and reinstituting some price corridors and changing our governance process on pricing. So when you step back, I think all of this gets back to -- the original premise was, we've got to get better at selling what we have today on the marketplace. And that's where the back end of '24 and then most of '25 is going to come from, which is why I think it's important to investors to understand that piece. The NPI will come over time. I'm very confident about that, but we've got to get better at selling what we have on the market today.

Scott Davis

Makes sense, Bill. And just -- I think when you talk about on-time-in-full, it seems very fundamental. But in theory, if you had 100% on-time-in-full, would your growth rate be 100 basis points higher, 200 basis points higher? Is there any way to narrow that down?

Bill Brown

Yes, it's hard to quantify. It's a good question. Clearly, running at 88% is not where we need to be. We're feeling -- we're running around 93 -- a little over 93% in Consumer. We should be in the high 90s. That's the expectation of some of the big box retailers. So we're getting there. We're doing better there. We're over 90% in the transportation business. That's good. It should be better. The concern really is in SIBG, the Safety and Industrial business, in the low 80s. We're definitely losing business for sure there. We are not delivering. When somebody needs something right now and we don't have it available, that is causing them to go someplace else even though we have a better brand, sometimes a better product, an attractive price. So it is costing us sales. So I do know that as a fundamental part of driving top line, we've got to get better at exercising the supply chain and making sure we meet our customers' expectations.

Nigel Coe - Wolfe Research - Analyst

Bill, you sound a little skeptical about the 1.9% IPI forecast just based on that's where we were at this time last year. So I'm just wondering, when you went through the plan process, look at the bottoms up projections from the businesses, and then you overlay that with the top down, what kind of haircuts have you taken to that 1.9%?

And then that brings me on to my next question, the real question, I guess. What have you baked in for pricing in 2025? And then just going forward, what is the framework here? Is it IPI plus price? Is it IPI multiplied by some factor plus price? I mean, any way to think about that growth function going forward?

Bill Brown

So it's a good question. I don’t think we're going to deconstruct the elements of growth between price and volume and share gain, other parts of it. But look, we did enter '24 with an expectation that IPI was going to be a bit better, and it softened through the year. There was an expectation of auto builds, and that softened quite a bit in the back end of the year. As we were, three months ago, thinking about IPI in 2025, it was higher than we actually are sitting at today, it was around 2.4%. The auto build was, at that point in time, higher expectation for '25 than we sit here today. So these indicators, they're just that. They're indicators. And we use them. It's an important dimension. But it's a starting point.

Of course, we've done a bottoms-up review of our business. We feel confident that 2% to 3% is the right place to be. When you look at a blended macro between IPI and GDP, because we're about 80% weighted to IPI, 20% to GDP, it's around 2.1. So the center point at 2.5 is a little bit above the macro. We know that some of the initiatives we're putting in place around commercial execution, new product development, getting our factories run a bit better, those are all very important dimensions.

But Nigel, again, it's -- we're two, three weeks into the year. We've got a new administration in Washington. There's lots of conversations floating around tariffs. We'll see as the year goes by, both progress and traction of some of the initiatives we have internally plus what happens in the macro, and we'll update investors accordingly. So right now, we feel good about 2% to 3% as the right place to start in '25.

Nigel Coe

Great. Thanks, Bill. And then, Anurag, for you. Thanks for the details on the margin bridge. The $150 million of net productivity, that appears to be mainly the payback on restructuring actions in 2024. So I'm just wondering if there's anything from some of the more structural drivers, such as improving OEE, improving footprint, supply chain, et cetera?

Anurag Maheshwari

Yeah, there is. So let me break up the $150 million in a little bit more detail, yeah? So first, just on the headwinds over there. So I said it was $100 million of stranded costs. The incremental investments we are making as well, which is about $225 million; some we did in '24, some in '25. It's both carryover as well as in year. So we've added the two together. It's about $325 million-ish, $350 million. Now offsetting that, you're correct. There is probably $70 million of restructuring benefits, about $280 million. But then to get to the positive $150 million, we're driving about more than $400 million of net productivity. And that is coming through -- again, through supply chain, be it procurement, more on the G&A efficiency, and a few of the other areas that Bill has spoken about. So overall, I would say the productivity driving is $450 million. That's being offset by all these other line items to get us to $150 million.

Andrew Kaplowitz - Citi – Analyst

Bill, you had mentioned in the conference circuit in December that you saw a bit of an uptick in industrial demand in Q4. Did that continue into January here? Do you think it was just related to prebuy ahead of tariffs or could it have been a reflection of maybe some modest recovery in short cycle markets? How would you characterize it?

Bill Brown

Yeah. So we did see, I'd say, across the industrial part of the portfolio -- I'm not referring to the consumer side, but the industrial part of the portfolio. We did see order rates -- first of all, they're very steady through the quarter, which I think was very positive. They are a tick higher than they were in Q3. The order rates were somewhat higher than the growth rate -- organic growth rate in the quarter. So there's a bit of backlog that was built into 2025. Those are all good indicators. But we are a shorter-cycle business, so we don't really live off backlog. It's more of a book-and-ship type business. But they're small little indicators. It was pretty broad-based. There was no specific region or business that was the driver of it. That also is somewhat encouraging.

Again, it's -- and I contrast that to where we were in Q4 of '23, where I think there was a pretty dramatic tail off in orders towards the back end of December, which got the team a little bit shaken in some ways. We did not see that happen here. So those are all good indicators, which is why when we look at 2%, 2.1% organic growth in Q4 that -- we feel that that's a good floor, if you will, for 2025. But I think it's good news. It's holding steady. And again, it's a reflection of some modestly improvements in the industrial markets. But again, it's early days.

Andrew Kaplowitz

Helpful. And Anurag, can you give more color into '25 margin guidance by segment? And then also comment on TEBG margin, particularly in Q4 '24. It seemed a little weak in Q4 versus the other segments.

Anurag Maheshwari

Yeah. So first, let me talk about Q4, and then I'll get into '25. So overall, Q4 came in better than expected across -- from our expectations, what we gave in the October guide, across all the three segments. And as I noted in my prepared comments, it's probably $0.05 higher than where our midpoint of our guide was because of volume and productivity, with FX being the big headwind in the quarter, which was unexpected.

Now on TEBG, we did expect the margins to be lower in Q4, seasonally, of course, between Q3 and Q4 because of underabsorption as we clear out inventory. So that was a big reason. And if you look between Q3 and Q4, sequentially, we improved inventory by eight days. So that clearly has an absorption issue. Second is we start making growth investments, which we are seeing in the revenue right now. That was a driver for it. And FX, TEBG does have a fair amount of business outside the US, so that impacts it as well. So you put all these three things together, the margin is lower. It actually came in better than what we expected. So overall, if I look at all the three business groups for '24, the margins came in a little bit better than expected.

As we go into '25, we're probably not giving guidance right now very specific to each of the segments. But the 130 to 190 range that we gave in terms of margin expansion, we expect all the three business groups to grow quite a bit. The TEBG could be a little bit lighter than the other two because they are the PFAS-stranded costs. A large part of it is in TEBG. But having said that, we expect good margin expansion across all the three business groups.

Julian Mitchell - Barclays Estimates - Analyst

Maybe just the first question, I'm trying to understand the sort of operating margin expansion framework. So you talked about, I think, Anurag, $450 million of overall productivity improvement in 2025. In the past or recent past, let's say, Bill, you've talked about that $250 million, $260 million COGS productivity numbers so -- as a sort of annual placeholder. So just trying to understand the delta between that. I'm guessing $450 million is not a medium-term placeholder because you have some extra savings this year from the 2023 plan. But maybe just help us understand how to think about productivity on top of that 35% core leverage placeholder.

Anurag Maheshwari

So Julian, you're correct. What we have said is, on the COGS line, 2% net productivity, which is about $250 million. The productivity, which I'm talking about is overall for the company, which also includes SG&A, other parts of the business as well. It also has a one quarter of the TSA reimbursement, which overlaps over there, too, right? So if you -- so those are the pieces which takes us to $450 million. I mean, we'll provide more on the Investor Day in terms of the framework looking forward. But I think our goal is still to get 2% net productivity in COGS and for even on SG&A line to see whatever productivity we can get to offset inflation and other investments that we are making.

Julian Mitchell

Thanks a lot. And I'll leave other medium-term questions for that event. So maybe just on the very short term, Anurag, I think you'd mentioned $1.70-ish of EPS adjusted in Q1. The first half is just under $4 though, I think, based on that 50% comment. So you've got a decent sequential step up in the second quarter in EPS. Maybe just any very large puts and takes. It seems like organic growth pretty steady year-on-year, but anything you're calling out Q1 to Q2 delta.

Anurag Maheshwari

Yeah. Thanks for the question. So let me break it up into two parts. One is some discrete items in the first quarter, and the second is on the recurring operational performance and non-op impact, which you should see through the year. On the discrete items, as I mentioned in my prepared comments, due to the Solventum spin, there were a few pieces. But a large part of it was the equity-based compensation, which I called out last year, we accrued in the second quarter. And as this year, as we're returning back to historical trends, we'll be accruing it in the first quarter. This is about a $0.15 headwind in the first quarter, which becomes a tailwind in the second quarter.

On the operational side, we'll see good flow-through from volume, lower restructuring costs, TSA absorption, all the productivity that we spoke about which will offset PFAS stranded and mix headwind and also all the growth investments. So this should be about $0.20 to $0.25 of EPS growth in the quarter. On the non-op, we have $0.40 for the year. So the first quarter is probably going to be closer to $0.08 to $0.10. So if you put all these items together, Julian, you've got $0.20, $0.25 of operational EPS growth. You minus the $0.08 of non-op and the $0.15 of equity-based comp. So the earnings are flat to Q1 of last year.

Now as you move into the second quarter, if we continue the similar trajectory on operating performance and the non-op headwind, it will be $0.10, $0.15 of EPS growth, and then you add back the $0.15 of the equity-based compensation. So the growth in Q2 would be closer to $0.25, $0.30. So that's a bridge between Q1 and Q2. And then to your math, the first half and second half should be fairly equal in terms of EPS.

Steve Tusa - JPMorgan - Analyst

Can you just talk a little bit about -- I'm not sure you mentioned it before, but the price assumption for this year.

Bill Brown

No, we've not talked about that. I don't think we're going to disaggregate organic growth. And it's embedded in the 2% to 3%. I think as we said before in the past, we do get price increases. The price increases cover mature cost inflation. And I expect it to be in a similar magnitude in '25, but we're not going to get that specific number here today.

Steve Tusa

And is that a net positive or you're just covering it?

Bill Brown

No, it will be a net positive in this year, yeah.

Steve Tusa

Okay. And then just one follow-up. On the T&E segment in the fourth quarter, margin was a little bit weaker than we were expecting. Anything in particular going on there in the fourth.

Anurag Maheshwari

No. In fact, as I mentioned earlier, Steve, it's probably a little bit better than expected. Nothing unusual. This is -- it's a combination of seasonality as you bring inventory down, some growth investments we made. But as you move into '25, you should see margin expansion again in TEBG. TEBG was actually our highest margin expansion segment in '24 by growing over 220 basis points. So I would say nothing unusual other than the fourth quarter. It's just timing of different things.

Steve Tusa

And then sorry, one more. Just on the corporate side, a little bit lower in expense this year. How does that look going forward? Is that a sustainable number in the model going forward in the '26, '27, the corporate side?

Anurag Maheshwari

Yeah. We'll talk about '25 right now, first, Steve. On '25, two pieces over there, both equal. It's about $60 million each. One is just a reallocation between corporate and the business group. This is one last quarter of overlap over there because we did it for nine months of the year. So one is just a reallocation. And the second is covering the TSA absorption costs, about $60 million. So those are the only two pieces in corporate.

Andrew Obin - BofA Global Research - Analyst

Can we just talk about free cash flow, good improvement in free cash flow conversion this year? As we think about next year, this squiggly line 100% free cash flow conversion, what working capital benefit do you have dialed in? And what are there offsets in terms of cash flow to keep it at 100% because you do have working capital relief program and I would have expected that you could deliver over 100% quite sustainably for a number of years?

Anurag Maheshwari

Yeah. Thanks for the question. Yeah, we did very well in '24, as you could see, 111% conversion, really good on the working capital as well where we improved the cash conversion cycle by eight days. It's early days right now in '25. The reason we put 100% conversion is once CapEx is in line with depreciation, we'll continue to invest on the growth side as well as sustainability, the CapEx in line with depreciation.

On the working capital, two things. As revenue goes up, obviously, we're going to consume more on the receivables side. Well, we continue to offset it by inventory. The goal is to get to 75 days. We showed good progress in '24; we'll continue that in '25. Now we strive to do better than that. So as the year goes by, if we do better on inventory to offset the DSO impact, there could be more than 100%. But that's the number we're going to start with and move from there.

Andrew Obin

All right, great. And just a question on abrasives and industrial specialties. It seems to be a nice canary in the coal mine short-cycle business. It's been consistently declining for a while. You do sound more optimistic. But if you look at these numbers, they seem to be relatively flat for the past four to six quarters. Any visibility there? When do they turn positive? What are you seeing in the channel? What are you seeing at inventory levels at OEMs? I know auto is probably a decent market there, but just more color as to when do you think these businesses could turn.

Bill Brown

So good question. I mean, so both businesses in the year were down low-single digits. They're very different. Industrial specialties is a grouping of lots of different pieces. Some are growing, some are not. Overall, it's been declining, but we see that flattening out and starting to grow over time.

On the abrasive side, we should see a better '25 than '24. Part of it is because of the industrial economy. Part of it is because of the launch of a new product offering called Cubitron 3 that we launched over the last year. It's now moving into a variety of different instantiations of different abrasive products. It's growing. It's got tremendous differentiation versus competitors. So we feel very positive about that. So we see that getting a little bit better here in '25. Part of it is because of the new products being introduced. So we think it's going to both turn the corner here in '25.

Andrew Obin

But no commitment Q1, Q2, nothing specific like that?

Bill Brown

It's a little bit granular. We'll come out -- I probably can say more about this at the Investor Day when Chris talks about the individual components of this business, but nothing more today. You asked about the inventory in the channel. That's been pretty normalized. There's not any significant concern one way or the other about inventory in the industrial channel. So that's not really the big driver here.

Amit Mehrotra - UBS Equities - Analyst

Anurag, one of the things that obviously stood out to me is the expectation for profit growth to be well in excess of revenue growth for this year. You obviously provided a very helpful walk around how we get there. But as we're coming up in late February, we think about the multi-year outlook, do we expect a high level of incrementals to be sustainable? It doesn't have to be over 100%, but can we expect a higher level of incrementals on a sustainable basis as some of these cost initiatives have legs?

And I also assume cash flow is going to grow in excess of earnings growth over the next several years. And if you could just talk about that – and I'm trying to square that with a 2025 buyback guide. That's a little bit lower than what you kind of exited at from a run rate perspective.

Anurag Maheshwari

Thanks for the question. So on Investor Day, we'll provide a framework as we look out at the medium term as to what's going to drive the sales growth and from the sales are we going to get gross margin expansion, which is going to flow through to the bottom line. So you're absolutely correct. We will provide that framework as we get into the end of the month in February, yeah.

On the cash flow side, listen, as growth -- as we continue to grow, that is going to be a drag on receivables. But we have put an inventory goal out there for 75. We feel it's a good path for us to get there. We're executing well towards that. And it's 100% conversion. If you look historically at 3M, it's been around there. But going forward, depending on revenue being the big variable here as well, but on inventory being something we can control, drive would be to be over 100% conversion.

Amit Mehrotra

Okay. Just maybe a bigger picture question for Bill. I would love to get it -- you mentioned earlier about industrial OTIF stubbornly in that low 80% level. Obviously, that's a pretty big deal, just given the size of that business. Can you talk about maybe when you expect to see more progress on that and talk a little bit about the manufacturing and DC footprint and when you expect to make more progress on that as well?

Bill Brown

So Amit, look, I may expect more progress on SIBG OTIF in January. We expect it in February. We did not expect the deterioration we saw in November and December. Part of it is certain specific issues, quality issues, a couple of specific assets at SIBG. One of the things that I've been reminded about by people is it's a much more complicated portfolio. It's about 35% more SKUs in SIBG than TEBG and probably more than double the number that's in CBG. So it's a pretty complicated portfolio. That being -- and there's been some unique supplier challenges in that business as well. But that being said, we expect that business to be closer to 90% this year. Maybe it's towards the end of the year, but we need to be making sequential improvement throughout the year on SIBG OTIF. I know Chris is depending upon that, salesforce is depending upon that, and more importantly, our customers are. So that's -- we're on it. We're pushing on it. It's certainly gotten a lot of attention inside the company, and the team is pretty laser-focused on making those improvements.

I think you talked about the complexity as well in the network. Look, I'd say it's part of a longer-term plan in terms of operational excellence. The first part really is making sure that all of our factories have an improvement target, an improvement plan, for how they run their four-wall spend. We will also be looking at how we can run this network that we have today more efficiently. And then over time, as we really mature the operating equipment efficiency metric, which is a measure of utilization of assets -- as that gets more mature, then we can start taking on a little more of a holistic look at the overall network. But right now, it's really just focused on blocking and tackling inside the factories. And I think we've got a lot of opportunity in front of us to improve in those dimensions.

Nicole DeBlase - Deutsche Bank - Analyst

Maybe just starting with China, I think you're expecting a little bit of a slowdown to mid-single digits in 2025, but definitely not too shabby. I guess, can you talk a little bit more about what you're seeing on the ground there?

Bill Brown

Yeah. So from a macro perspective, China is expected to slow a little bit, both from a GDP and IPI perspective. But again, it depends on what you believe in those forecasts, in those numbers. Now I do think that tariffs could have an effect on what's happening in China, certainly on the export part of China. So we're watching it very, very carefully. There's news of the minute on tariffs for sure. So just stepping back, Nicole, China is about 10% of our revenue globally. Last year, it was up about 10%. It was up about 13% in the first half. It slowed down in the back. Part of it is from electronics. When I look at -- so half the business is export, and that's been -- electronics has been an important driver. But the other half, that's really, if you will, China for China, that did grow. It was up about 3% last year. So we saw a decent growth on the ground, not quite at macro, but decent growth. We had quite a bit of activity in December, quite a bit of activity happening here in January. Again, it's -- you never know. It could be some pull aheads. It could be just getting ahead of Chinese New Year, which is end of January. We do expect that our business in China will be slower in '25 than it was in 2024. Probably in the low single-digit range is what we expect for revenue for 3M in China.

Nicole DeBlase

Got it. That's really helpful. Thanks, Bill. And then any update on insurance recoveries? I think you promised us an update each quarter. Thank you.

Bill Brown

So we've -- we're making progress on insurance. And we're actively engaged in arbitration, negotiations in some places, litigation with insurance carriers for both for PWS and Combat Arms. In Q4, we recovered about $170 million. So to date, so through last year, it was about $340 million, mostly in the Combat Arms area. Again, we're pretty active in pushing this. The legal teams are driving this pretty hard. And as I said last time, I'll say it again, we expect our insurers to honor the commitments they have to us and their policies. And we're going to make sure that they go and do that. So that's where we stand today.

Joe O'Dea - Wells Fargo Securities, LLC - Analyst

Just wanted to ask on cash and just what you think the right amount of cash to carry is. So you ended the year with cash and marketable securities at about $7.7 billion. Where do you expect to end 2025? And then thinking maybe a little bit further out, just what you think the right amount of cash to have is whether it's a percent of sales or a dollar amount?

Anurag Maheshwari

So we -- as you correctly said, we ended the year at $7.7 billion. It's probably 2x of the working capital requirement for the business. If you look at '25, we said we're going to buy back shares worth $1.5 billion. At current dividend rate, we're paying about $1.5 billion, $1.6 billion in dividends, $3 billion. We got $3 billion to settle on Combat Arms and PWS as well. So these are the big ones we have for the year, and our plan is to refinance the majority of our debt. So if you put all of that together, we should end '25 at over $6 billion in cash.

Joe O'Dea

And then also, Bill, on industrial production and -- what are you watching most closely there, whether it's a region or whether it's an end market, in terms of how you're thinking about where the best potential sits for this accelerating industrial production that we're all waiting for?

Bill Brown

Yeah. So we're looking at all the different pieces. Obviously, we're pretty levered to the manufacturing economy within IPI. So that's an important one. And we're a little bit heavier weighted in the US and probably Europe and others after that. So clearly, US is an important focus of ours in watching IPI. The current forecast is it does turn positive from a minus 0.3 to plus 0.5, I think, is what it was in 2025. And Europe, we have to watch. We've got a pretty good presence in Europe as well. It's a very big turnaround in Europe from down 60 basis points to up 130 basis points next year. That's a pretty big movement.

So those are the key things that we're looking at, I think, pretty carefully on IPI. And that's on the industrial side. On auto, look, I'm a little bit concerned about that only because we had some deterioration last year. The auto build forecast for this year is weakened a little bit, down 60 basis points. But when you -- as I mentioned in my remarks, when you disaggregate that, US and Europe are down 3 to 4 points. China is flat, and the rest of Asia is up a little bit. So we have to watch that and look at where our content per vehicle happens to be. Obviously, the team is very focused on gaining share, gaining content in those automakers that are growing faster. That's a very important strategic focus of Wendy and her team. But those are some of the things that we're looking at from a macro perspective.

Deane Dray - RBC Capital Markets - Analyst

I wanted to circle back on the strategies for reinvigorating new product introductions, but specifically reinvigorating innovation. I know we're going to start off the analyst event at the technology center. Just -- I think there's art and science here when it comes to innovation. I'd just be interested in your thoughts. You can't just dump cash at the front door and say, innovate. But I know you're adding some headcount. Are there any other thoughts there in terms of ramping up innovation? And how do you feel about that long-standing policy at 3M R&D, where the senior scientists get 15% of unbudgeted time? Does that still fit into the equation?

Bill Brown

Look, so 15% of time is a hallmark of the company. I joked it's 115%, not going from 85% to 100%, but everyone gets their 15%. And I think that's important because it gives people a time to step back and think and ponder. I mean, I do the same thing. I go into my office that I think about what are the issues upon the company. And we all have to do that. So I think that's a hallmark of the culture of the organization.

I think the first -- look, it's not a shortage of ideas in concept for where we can innovate. I think we've got a great list of products. As you turn the scientists, the engineers on, the people doing product development, those in the business units, those out meeting with the customers themselves, the ideas are there. The pipeline is pretty full.

We've got to do more to keep filling it up. But the pipeline has been full. I think it's about just turning on that -- and unleashing that energy that's in the folks that do the innovation. And so part of it is eliminating some of the bottlenecks in the processes, and I went through last time a number of pieces of that. We are shifting within our capital budget more investment to R&D for lab equipment, for prototype equipment to speed up the prototyping and scaling up of innovation. We are adding resources there. I think if you put the right framework in place and you're motivating the teams in the way we are, and we're starting to focus people on the growth verticals that we really want to focus our investment and time on, I do think that, that's going to pay dividends over time. This is something that Wendy in TEBG is going to lay out pretty clearly when we get out to the end of February when we have our Investor Day. How do we get closer to those innovation partners so that we're really tied with them very closely, so their ideas translate back to us? And we're working with them in not a transactional way, but in a strategic way. And I think if you do all of these things, this machine will turn on. And again, we saw good progress over the last six months. It's early days. I think we'll have another good year in '25.

But ultimately, this is going to come down to, are we growing faster than the market? Therefore, we're gaining share. And are we driving margin and margin expansion because the products we're offering to the marketplace are better than what the competition puts on the marketplace? And I think that's the end objective. We have a good start.

Deane Dray

That's great to hear, especially that support of that 15% unbudgeted time. That's -- I'm sure a lot of people like hearing that. And then just second question, a quick follow-up on the plan for reducing inventory days. I mean, I know there's an immediate benefit for free cash flow. But is there any pressure on service levels once you start to reduce the level of inventory? And is there any trade-off there? Thanks.

Bill Brown

Look, that's something that we're watching very, very carefully. We came down two days year over year. I think it was eight days sequentially in Q4. In SIBG, we saw sort of OTIF come back. So we're watching this very carefully. Our intention is to prioritize OTIF over inventory, frankly. That's what we think is really important. That's a greater lever. That being said, there are opportunities to eliminate the waste, if you will, in inventory. Not all the inventory we have is good inventory. We have a lot that's stuck on the water. We have a lot of components in warehouses and factories. We have to make sure we have the right inventory. That's why I believe this is the and, not the or, I believe that we can get to 75 days and over 90% OTIF. And I think we can get there. That's our goal. That's what we ought to be shooting for. It's not going to be linear, and we saw it in Q4. It wasn't linear. We had better inventory, not as good on OTIF, at least in one segment. But that's the objective. And again, we're going to prioritize OTIF over inventory, knowing that we'll get the inventory over time.

Bill Brown

Okay. Well, thank you. I appreciate everyone's time and attention today. I know we're running top of the hour here, but I want to thank all of the 3Mers for their continued hard work and dedication to our customers and our shareholders. I look forward to introducing you all, analysts and investors, to the senior leadership team at 3M at our Investor Day coming up on February 26 in St. Paul. It's going to be brisk. Today is minus 18, so dress warmly. So we look forward to seeing you on the 26th. Thank you very much, and have a good day.