



**Q4 2015 Earnings Call Transcript
Inge Thulin & Nicholas Gangestad
January 26, 2016**

Slide 1, Opening

Matt Ginter, Treasurer and Vice President, Investor Relations

Thank you and good morning everyone. Welcome to our fourth quarter 2015 business review.

Let me kick off with a reminder of our upcoming 2016 investor events. On Tuesday, March 29th, we will be hosting an investor day at our headquarters in St. Paul. There will also be a welcome reception the evening before at our new R&D lab, please plan accordingly. Registration for the event will be sent out later today.

Also, our upcoming quarterly earnings calls are scheduled for April 26th, July 26th and October 25th.

On the call today are Inge Thulin, 3M's chairman, president and CEO, and Nick Gangestad, our chief financial officer.

Each will make some formal comments and then we'll take your questions.

Today's earnings release and slide presentation are posted on our investor relations website at 3M.com.

Slide 2, Forward Looking Statement

Matt Ginter

Please take a moment to read the forward-looking statement on slide two.

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

Please turn to slide three and I will hand off to Inge.

Inge.

Slide 3, Q4 2015 Summary
Inge Thulin, Chairman, President and CEO

Thank you, Matt.

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

I will open my remarks with an overview of our fourth quarter and later in the call, I will give you a recap of our full-year performance.

3M finished 2015 with another quarter of disciplined execution, in a challenging external environment.

Across our enterprise we controlled the controllable, while investing in our business and returning cash to our shareholders.

With respect to our earnings per share, we posted GAAP EPS of \$1.66 down 8 percent year over year.

As you recall, in October we announced a corporate restructuring, which was completed in the fourth quarter.

This action resulted in a Q4 pre-tax charge of \$114 million, and will deliver savings of \$130 million in 2016.

Excluding this Q4 charge, we posted earnings per share of \$1.80.

Companywide, organic local currency sales declined 1.1 percent.

Consistent with our expectations at our December Outlook meeting, organic growth was down low-single digits in our two industrial-related businesses namely, Industrial, and Safety and Graphics.

Also, as expected, Electronics and Energy decreased in the high single digits, as the consumer electronics market softened.

On the positive side, our two consumer-driven businesses posted strong organic growth in the quarter.

Consumer was up nearly 3 percent organically while Health Care increased almost 5 percent, its highest growth of the year.

Acquisitions added 1.5 percentage points to our sales, while the stronger U.S. dollar reduced sales by nearly 6 percent.

In total, Q4 sales were \$7.3 billion.

Looking at margins, we delivered another good, broad-based performance in the quarter.

When you exclude restructuring, margins were up 60 basis points to a healthy 22 percent with four of our five business groups posting margins greater than 21 percent.

In the fourth quarter we posted strong free cash flow with a robust 182 percent conversion.

We also continued to invest in our business while returning nearly \$2 billion to our shareholders through dividends and share repurchases.

Overall, we had a solid finish to the year and now I will turn the call over to Nick, who will go through the details of the quarter.

Nick

Slide 4, Q4 2015 Sales Recap

Nick Gangestad, Senior Vice President and Chief Financial Officer

Thank you, Inge, and good morning everyone. I'll start by covering sales growth on slide four.

Organic local currency sales declined 1.1 percent in the fourth quarter with volumes down 2.3 percent, partially offset by selling prices, which were up 1.2 percent.

Acquisitions, net of divestitures, added 1.5 percentage points to sales. This impact includes the acquisitions of Capital Safety, Polypore's Separations Media business and Ivera Medical along with the divestitures of Library Systems and our license plate converting business in France.

Finally, foreign currency impacts reduced sales by 5.8 percentage points, with notable year-on-year declines in the Euro, Yen and Brazilian Real.

As a result, in U.S. dollar terms, fourth quarter worldwide sales declined 5.4 percent versus last year.

In the United States, organic growth was down slightly as we experienced weak end-market demand in our industrial-related businesses. At the same time, our consumer-oriented businesses, Health Care and Consumer, continued to deliver positive organic growth.

Organic growth in Asia Pacific declined 2.7 percent. Three of our five business groups posted positive growth in the region, led by Health Care and Consumer, while Electronics and Energy declined high-single digits.

Within Asia Pacific, organic growth declined by 3 percent in both Japan and China/Hong Kong. Excluding our electronics businesses, Japan was up 3 percent organically, while China/Hong Kong declined 3 percent.

Moving to EMEA, organic growth increased 1.1 percent with Central/East Europe up high-single digits, West Europe up slightly, and Middle East/Africa down mid-single digits.

Finally, organic growth in Latin America/Canada declined 60 basis points.

Brazil declined 6 percent while Mexico continued its trend of strong organic growth, increasing 7 percent.

Please turn to slide five for the fourth-quarter P&L.

Slide 5, Q4 2015 P&L
Nick Gangestad

Companywide, fourth-quarter sales were \$7.3 billion dollars, with operating income of \$1.5 billion dollars.

GAAP operating margins in the quarter were 20.5 percent, down one percentage point year-on-year.

Excluding restructuring, margins increased 60 basis points to 22.1 percent which reflects our ability to execute and effectively control those things within our control.

On the right-hand side of this slide, you'll see the various components of our fourth-quarter margin performance.

Let me comment on the primary drivers impacting margins during the quarter.

Lower raw material costs and higher selling prices contributed 2 percentage points of margin expansion.

Our global sourcing teams continue to capitalize on the impact of lower commodity prices, and are generating additional savings above market.

Foreign currency, net of hedge gains, decreased margins by 30 basis points.

Fourth quarter strategic investments lowered margins by 40 basis points, primarily driven by portfolio management actions in our renewable energy business.

Similar to past quarters, higher pension and OPEB expense reduced margins by 60 basis points.

Finally, our fourth-quarter pre-tax restructuring charge of \$114 million, reduced margins by 160 basis points.

As Inge mentioned, these actions will result in pre-tax savings of approximately \$130 million in 2016.

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

Slide 6, Q4 2015 EPS
Nick Gangestad

Fourth-quarter GAAP earnings were \$1.66 per share, down 8.3 percent year-on-year.

Our restructuring decreased GAAP earnings by \$0.14 per share, excluding these costs, earnings were \$1.80.

As you see, a number of other factors also impacted our earnings.

Growth and margin expansion added \$0.03 to earnings in the quarter, which includes headwinds of \$0.05 from pension expense, and \$0.04 from strategic investments.

Excluding restructuring, our fourth-quarter tax rate was 28.6 percent versus 28.0 percent in last year's fourth quarter. This reduced earnings by \$0.01 per share.

Foreign-currency impacts, net of hedging, reduced pre-tax earnings by \$96 million or the equivalent of \$0.11 per share.

Acquisitions and divestitures increased earnings by \$0.02 per share.

Finally, average diluted shares outstanding declined 4 percent year-over-year which added \$0.06 to fourth-quarter EPS.

Please turn to slide seven.

Slide 7, Q4 2015 Cash Flow
Nick Gangestad

We delivered strong free cash flow in the fourth quarter, with a conversion rate of 182 percent. The primary driver was improved working capital.

Free cash flow was \$1.9 billion, up \$199 million year-over-year.

For the full-year, we posted free cash flow conversion of 103 percent, similar to 2014.

In 2015, we continued to manage toward a better-optimized capital structure. We added leverage of approximately \$4 billion, which helped fund investments in organic growth, acquisitions and the return of cash to shareholders.

In the fourth quarter, we invested \$446 million in cap-ex, bringing our full-year investment to just under \$1.5 billion. For 2016, we expect capital expenditures to be in the range of \$1.3 to \$1.5 billion.

Also in the fourth quarter, we returned \$1.8 billion to shareholders via dividends and gross share repurchases.

During 2015, we returned nearly \$8 billion to shareholders including cash dividends of \$2.6 billion, and gross share repurchases of \$5.2 billion.

Now let's review our business group performance, starting with Industrial on slide eight.

Slide 8, Industrial
Nick Gangestad

Industrial posted quarterly sales of \$2.5 billion.

Organic growth was minus 1.8 percent reflecting a slow industrial economy which impacted our business.

In particular, our advanced materials business declined high-single digits, impacted by weak demand in the oil and gas end market.

On a positive note, our automotive OEM business grew high-single digits, as we continue to gain share by increasing 3M's content per vehicle. This business has consistently grown faster than global car and light truck production levels.

3M Purification also posted strong organic growth in the quarter.

The acquisition of Polypore's Separations Media business, which enhances 3M's core filtration platform, added 1.7 percentage points to Industrial's sales growth. Integration activities and financial performance are on-track and meeting expectations.

On a geographic basis, Industrial's organic growth was positive in EMEA, Latin America/Canada and Asia Pacific while the U.S. declined mid-single digits.

The Industrial business delivered operating income of \$476 million in the quarter with operating margins of 19.3 percent, or 21.0 percent excluding restructuring.

In addition, the business is absorbing the Polypore Separations Media acquisition, which reduced margins by another 50 basis points.

Please turn to slide nine.

Slide 9, Safety and Graphics
Nick Gangestad

Fourth-quarter sales in Safety and Graphics were down 2.5 percent organically, to \$1.3 billion dollars.

As a reminder, organic growth in this business was up over 9 percent in Q4 2014, which included a \$30 million impact from Ebola-related demand for personal safety products. Excluding this impact, Q4 sales in our Safety and Graphics business was flat organically.

Within Safety and Graphics, our commercial solutions business had another solid quarter, which capped off a strong full-year of mid-single digit growth.

Acquisitions, net of the divestitures, added 4.6 percentage points to sales growth.

As a reminder, in August we acquired Capital Safety, a leading provider of fall protection equipment. Integration is on track, and the business is meeting operating income targets.

On a geographic basis, organic growth declined in all regions.

Operating income was \$282 million in the quarter, and operating margins increased 1.0 percentage point to 21.8 percent, or 22.7 percent excluding restructuring.

The net impact from acquisitions and divestitures, added 150 basis points to Safety and Graphics fourth quarter operating margins.

Please turn to slide ten.

Slide 10, Health Care Nick Gangestad

Our Health Care business generated fourth quarter sales of \$1.4 billion, with organic growth of 4.5 percent.

Organic growth was broad-based, led by double-digit increases in both health information systems and food safety with oral care up mid-single digits in the quarter.

The Ivera Medical acquisition added 80 basis points to fourth quarter sales growth and continues to exceed performance objectives.

Health Care grew organically in all geographic areas, led by Asia Pacific.

This business continues to drive penetration in developing markets, with 8 percent organic growth in the quarter. China/Hong Kong was particularly strong, with double-digit organic growth.

Operating income was \$444 million, up nearly 3 percent versus last year's fourth quarter.

Health Care's operating margins were 32.1 percent, up 110 basis points year-over-year or up 180 basis points excluding restructuring.

We continue to be pleased with the strong and consistent performance of our Health Care business, and will continue to invest in this business to drive greater success.

Next, let's cover Electronics and Energy on slide eleven.

Slide 11, Electronics and Energy

Nick Gangestad

Fourth quarter sales for this business group were \$1.2 billion, down 7.7 percent organically.

On the electronics side, organic sales declined 8 percent, impacted by weakness in the consumer electronics end market, and excess channel inventory. We expect this softness to continue into the first quarter.

Our energy-related businesses were down 6 percent organically as sales declined in renewable energy, telecom and electrical markets.

On a geographic basis, organic growth was down across all areas.

Operating income for Electronics and Energy was \$200 million with operating margins of 16.5 percent, or 17.5 percent excluding restructuring.

In addition, portfolio management actions in our renewable energy business, reduced Electronics and Energy margins by 2.4 percentage points.

For the full-year, operating margins were 21.1 percent, up from 19.9 percent in 2014.

Our portfolio actions in this business group over the last three years continued to pay off in 2015. These actions are enabling us to deliver solid margins, even in the face of challenging conditions in both the electronics and energy end markets.

I'll finish with our Consumer business on slide twelve.

Slide 12, Consumer

Nick Gangestad

Fourth-quarter sales in Consumer were \$1.1 billion.

Organic growth was a solid 2.7 percent, paced by our home improvement business.

This business continues to win in the marketplace with leading brands such as Filtrete™ filters and Command™ adhesives.

Stationery and office supplies, and home care, were also up organically while organic sales declined in consumer health care.

Fourth quarter holiday sales were strong, driven by solid demand for our category-leading Scotch® and Command™ branded products.

Looking at Consumer geographically, organic growth was broad-based across all areas, led by the U.S.

Consumer's operating income was \$254 million, with operating margins of 23.1 percent, or 23.4 percent excluding restructuring.

That wraps up our review of the fourth-quarter business results.

Please turn to slide thirteen, and I'll turn it back over to Inge.

Inge.

Slide 13, 2015 Full-Year Performance
Inge Thulin

Thank you, Nick.

With another solid margin and cash flow performance, our fourth quarter capped off a year of disciplined execution and efficient growth from our global team.

Even in a low-growth environment, we expanded full-year margins nearly a full percentage point to 23.3 percent, excluding restructuring.

In 2015, for the second year in a row, we posted free cash flow conversion above 100 percent.

We also delivered a strong return on invested capital of 22.5 percent coming on top of a 22 percent return in 2014.

Beyond these solid financial results, I view 2015 as a fundamentally important year in terms of 3M's future.

This is because of the investments we made and the actions we took to position our company for long-term success.

As you see, last year we invested a total of \$7 billion in research and development, acquisitions and cap-ex.

We also made significant progress on our three key levers, which represent important value creators for our enterprise.

The first is Portfolio Management, which is all about strengthening and focusing our portfolio of businesses.

We do this through both acquisitions and divestitures, and also through business consolidations.

Last year, we took action on all fronts.

In Health Care, for example, we combined our dental and orthodontic businesses, into a single Oral Care Solutions business.

Consolidating businesses allows us to allocate resources to our best opportunities while creating greater customer relevance, scale, productivity, and improved speed.

Since 2012, in fact, we have realigned from 6 sectors to 5 business groups and from 40 businesses to 26.

To complement organic growth, we also made three strategic acquisitions in 2015.

This includes Capital Safety and Polypore's Separations Media business, which enhance two of our core technology platforms: personal safety and filtration.

At the same time, we divested three businesses that no longer fit within our portfolio.

Investing in Innovation is our second lever.

Last year, we invested \$1.8 billion in research and development.

As you have heard me say many times, research and development is the heartbeat of our company.

It enables us to both invent and manufacture cutting-edge, relevant, and unique products for our customers.

This, in turn, drives organic growth which is our primary growth metric and also supports our premium margins and return on invested capital.

Last year, in addition to investing in technology development, we took action to better connect our scientific capabilities to our customers around the world.

In 2015 we opened 6 new customer technical centers including in West Europe, Middle East Africa, and Asia Pacific.

We also opened our new, state-of-the-art research laboratory in the United States which we look forward to showing you at our Investor Day in March.

Our third lever, Business Transformation, starts and ends with our customers.

It is about transforming our business processes to make it easier and quicker for our customers to do business with us, anywhere around the world.

The backbone of business transformation is our new, global ERP system.

In 2015 we made good progress, most recently with a successful roll-out in the Nordic countries.

We also announced the creation of three Global Service Centers which will optimize our delivery of transactional services, and serve as a broader platform for operational efficiencies into the future.

We expect Business Transformation to result in \$500 to \$700 million in annual operational savings by 2020, and another half-a-billion reduction in working capital.

That covers our three key levers, and I am very pleased with our progress.

In addition to the work we did on our levers, we made other investments to position 3M for success in both the short and long term.

As we have talked about before, we run our company with one eye on the microscope, and the other eye on the telescope ... or in other words, making sure we are positioned for success today, and many years into the future.

Let me give you two examples.

First, on the telescope view, we made a significant investment related to our brand equity.

Our 3M brand is strong, and last year we invested in a new brand platform, 3M Science Applied to Life, to make it even stronger.

This will enhance awareness of how 3M uses science to solve problems for our customers which goes back to our vision of improving every company, every home, and every life.

Next, on the microscope view, we completed a corporate restructuring focused on structural overhead and slower growing markets which will help us manage through the current economic realities.

And we made all these investments last year while also returning \$8 billion to our shareholders through dividends and share repurchases.

When I look upon all we accomplished in 2015, it was a fundamentally important year for the future of our enterprise.

As you see, we are continuing to build an even stronger, more competitive company that will win in 2016 and beyond.

Slide 14, 2016 Planning Estimate **Inge Thulin**

And on slide 14, you will see our planning estimates for this year which are unchanged from December's Outlook meeting.

We estimate earnings per share in the range of \$8.10 to \$8.45, an increase of 7 to 11 percent year over year.

Organic growth is expected to be 1 to 3 percent, with acquisitions adding 1 percent to sales.

Finally, we expect our free cash flow conversion in the range of 95 to 105 percent.

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

Conclude and Sign off

Inge Thulin

To wrap up, 2015 was an important year for 3M as we made investments and took actions to prepare ourselves for the future.

As a result, we are positioned to drive efficient growth and create greater value for our shareholders in 2016 and beyond.

Thank you for joining us, and we look forward to seeing all of you in March.

Have a good day.