SNAP-ON INCORPORATED

Moderator: Leslie Kratcoski
October 22, 2015
9:00 am CT

Operator: Good day and welcome to the Snap-on Incorporated 2015 Third Quarter Results Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Ms. Leslie Kratcoski. Please go ahead, ma'am.

Leslie Kratcoski: Thanks Kevin, and good morning, everyone. Thanks for joining us today to review Snap-on's third quarter results, which are detailed in our press release issued earlier this morning.

We have on the call today Nick Pinchuk, Snap-on's Chief Executive Officer; and Aldo Pagliari, Snap-on's Chief Financial Officer. Nick will kick off our call this morning with his perspective on our performance. Aldo will then provide a more detailed review of our financial results. After Nick provides some closing thoughts, we'll take your questions.

As usual, we have provided slides to supplement our discussion. These slides can be accessed under the Downloads tab in the webcast viewer as well as on our website under Investor Information. These slides will be archived on our website along with the transcript of today's call.

Any statements made during this call relative to management's expectations, estimates or beliefs or otherwise state management's or the company's outlook plans or projections are forward-looking statements and actual results may differ materially from those made in such statements. Additional information and the factors that could cause our results to differ materially from those in the forward-looking statements are contained in our SEC filings.

With that said, I'll now turn the call over to Nick Pinchuk. Nick?

Nicholas Pinchuk: Thanks, Leslie. Morning, everybody. As usual, I'll start with the third quarter highlights, provide an update on the environment and then speak a bit about our trends. Aldo will then provide a detailed review of the financials.

In the third quarter, we again showed progress along our runways for growth and for improvement, and we saw those gains across our operating segments. Organic sales were up 7.3% from last year. Opco operating margin, it reached 17.5%, up 130 basis points.

When you add the $43.5 million in operating earnings from Financial Services, up from $37.7 million in 2014, the consolidated operating margin was 21.2%, an increase of 160 basis points. And EPS, EPS was $1.98, up 22 cents or 12.5% from the $1.76 of last year.

Our reported sales increase was 1.9% including the impact of unfavorable foreign currency. And in this quarter, that total was $42.6 million, about the same as the second quarter. Adding the incremental $2.1 million sales from our third quarter acquisition of Ecotechnics, the total reported sales for the period were $821.5 million.

For automotive repair businesses, the environment continues to be favorable. Actually, it's been that way for a while. And our Tools Group and Repair Systems & Information, our RS&I Group, are both well positioned to take full advantage.

You can see it in the performance, another quarter of solid gains for both groups, advancing along our runways for growth. Clearly, the Tools Group demonstrated enhancements to the franchise network, gains in all its markets, continuing to take advantage of the opportunities that are so abundant in a changing vehicle fleet, not only in the United States, but in places like the UK and Australia.

And RS&I, with strong sales across North America and parts of Europe, double-digit growth in the U.S. and modest gains in Western Europe, offsetting the continuing softness in Eastern Europe and particularly in Russia.

RS&I progress achieved with independent repair shop owners and managers, and with OEM dealerships, advanced by our latest diagnostics and undercar product offerings.

For the Commercial & Industrial, or C&I Group, we overcame some increased headwinds with the overall organic sales rise offsetting mixed environments across industries and across geographies.

That said, in the third quarter, our European based hand tool businesses and our Asia Pacific operations recorded high single digit gains overcoming the turbulence within their particular markets.

Now our Industrial division did have some headwinds in the period, impacted by weak US military volume and slowdowns in our oil and gas activity. We've consistently mentioned the uncertainty associated with the military. In the third quarter, that caution materialized and our results included a double-digit decrease. Measured spending and budget constraints making the present tight and the future even more difficult to predict.

Within our Natural Resources segment, volume in oil and gas was down substantially. You see it in oil prices, and you read about it in the newspapers. And despite our small share and opportunities for penetration, we were impacted.

But that said, saying that, there will always be headwinds. They've been a factor in other quarters and they were present in the third quarter and we overcame, because we're well positioned to confront the challenges and proceed down all our runways for growth, enhancing the franchise network, expanding with repair shop owners and managers, extending the critical industries and building in emerging markets.

These do represent the avenues for advancement and there has been consistent progress along each of those paths. At the same time, those growth drivers are joined and supported by the benefits of Snap-on value creation, safety, quality, customer connection, innovation and rapid continuous improvement, or RCI. These are the processes, the tools we use each and every day to drive improvements, but this quarter we especially benefited from customer connection and innovation.

Customer connection. Snap-on's continuing pursuit of understanding of work derived from the hours and the days we spend with professionals. Innovation, taking that practical insight and matching it with the possibilities of modern technologies.

And in the quarter, those processes resulted in more prestigious product awards for the corporation. We were again honored with two MOTOR Magazine Top 20 Tool Awards. The winners this time are 3/8-inch Drive Steering Rack Sockets and our SOLUS Edge diagnostic handheld.

Let's talk about the steering rack socket. The S6229 was developed from a customer connection derived from direct observation of work and from conversations with multiple technicians.

This innovative tool allows the tech to replace power steering O-rings without removing the whole steering assembly, saving up to an hour of labor, clearly making work easier and professional repair more productive.

In addition, also created out of deep insight in the repair process, the innovative SOLUS Edge coverage for hundreds of vehicle systems, including hybrid, TPMS, steering and clean diesel, and it all comes loaded with our Fast-Track Troubleshooter database with its vehicle specific tips, tests and time savers.

The SOLUS Edge enhanced coverage - is enhanced coverage for over 40 car makes without the cost or complexity of factory scan tools. And for all its power, for all its strength, it's easy to use. The large 8-inch touchscreen display is an aid to visibility and the software provides accurate results in as little as 30 seconds, quick.

I mention these awards because they're just the most recent recognitions of a growing list of very popular products that provide unique advantages, created by the observations of our franchisees and direct salespeople who are committed to translating that insight into productivity innovations. And that broad value creation is reflected in the positive results registered across all our operating groups again this quarter.

Now let's focus on those individual groups. Starting with Commercial & Industrial, organic sales were up 3.4%, operating margins reached 14.3%, up 60 basis points from last year's 13.7%, growth along with the benefits of Snap-on value creation.

Now I said, as we said, there are headwinds, but our Industrial direct salesmen have been expanding their reach nevertheless into sectors like railroads, up double-digits, growing our presence, offering a wider variety of tools and tool control solutions.

We've spoken in the past about building our understanding of work in critical industries, expanding our customer connections. Well, one way that's happening is by using our experience in RCI. Participating in customer lean events, participating in the customer sponsored lean events, our team was able to assist in improving railroad operations, while at the same time gaining a better understanding of their work processes, their product requirements, their business needs and their overall industry direction, all key customer connections gained through lean event participation.

One of the tools conceived from those insights was our special extendable line of tube wrenches, great for heavy-duty work on railroad cars and tracks. Made in our Elizabethton, Tennessee plant, these tube wrenches replace the traditional slugging wrenches in railroad applications, allowing the operator better access, eliminating the need for costly two-person slugging procedures and making work easier, safer and more productive.

Let's speak about SNA Europe. Now, eight quarters in a row of year-over-year growth, navigating through some of the most difficult geographies and tepid economies. SNA Europe activities continues to be encouraged - activity continues to be encouraging. But its profits are even more positive, now up significantly for 10 straight quarters. And we believe there's much more room for further gains.

And related to our Asia Pacific operations, the environments are mixed, but we had overall gains with upward movement in places like Thailand and Indonesia and Vietnam. Actually it's nice to see progress in Vietnam, that emerging Southeast Asia nation. So that provides a bit of color on C&I.

Now, on to the Tools Group. Organic sales up 11%, 11%, significant growth in the U.S. and internationally. Operating income $56.3 million compared to $49.5 million in 2014. Operating income margins of 14.8% rose 90 basis points from last year's 13.9%.

The additional volume as well as operating improvements from RCI translated into significant margin improvement, and that 90 basis point gain overcame 120 basis points of negative currency.

When you consider the Tools Group's success, you see the power of Snap-on value creation, and the benefits of our award-winning innovative new products. Besides the MOTOR Top 20 award, the Tools Group also received recognition from the readers of Professional Tool & Equipment News, gaining five People's Choice selections for new tool innovation, products once again born at the intersection between customer connection insight and advanced technology wielded by our innovation teams, products like the KRL, 72-inch Roll Cab with its Power Tool Organizer System, the powerful and light CT8850, 18-volt cordless impact wrench, our new brake caliper press, our new advanced battery system tester with its print capability, and our new EET2 full view welding helmet, all selected by the readers of PTEN Magazine and by our technician customers as great new products, products that make work easier and products that provide further evidence of Snap-on innovation.

You might remember that the third quarter is also when we hold the annual Snap-on Franchisees Conference, our SFC. This year it was in Washington, DC, with more than 8,000 attendees, franchise and family members from over 3000 routes. Three days of showcasing the opportunities to enhance the franchise channel, to amplify the power of our van space and of our franchisees' time. And based on the optimism and the confidence of our franchisees, it was a strong success. And by the way, orders were up once again, beating the record level achieved in 2014.

When we speak of the van channel, we also have to consider the very strategic contributions of Snap-on Credit. Our Financial Services arm helps create opportunities across our organization, but especially within the Tools Group and Credit had a strong presence at the SFC. Supporting franchisees with unique programs, enabling sales of those big ticket items, which are so essential to franchisee success. And in the third quarter, Financial Services OI was up $5.8 million or 15.4%, another period of powerful contribution to the organization.

Let's move to RS&I. Organic sales were up 8.2%. The operating margin of 24.6%, it increased 130 basis points from 23.3% just last year. RS&I was charged with expanding our presence to repair shop owners and managers and in the quarter, it did just that.

We once again had growth in our businesses providing repair, information and diagnostics to independents. In fact, we appear to be gaining traction across many dimensions in automotive, in medium and in heavy duty garages, serving both OEM dealerships as well as those independent shops, all fueled by our expanding product offering.

And one of those great RS&I product came from our diagnostics division, demonstrating its continuing innovation. Our diagnostics team launched its new VERUS Edge handheld, an enhanced top-of-the-line offering. Thinner, lighter, including important features like five-second ready-to-use capability, five-hour battery life, a solid state hard drive for increased durability. And, of course, access to our unique integrated SureTrack real-world fixes based on masses of actual repair data, all features guided by effective customer connection input.

In the VERUS Edge, we believe we have a winner, advancing the state-of-the-art and addressing the most serious of repair challenges, and initial sales of breaking the records and exceeding our expectations.

Also in the third quarter and with the focus on heavy duty shops, RS&I introduced the latest generation of its proprietary vehicle interface, the Nexiq USB-Link 2, now with Wi-Fi connectivity. It extends our leading position by adding wireless capabilities to the already successful family of Nexiq heavy duty diagnostics product.

The USB-Link 2 is compatible with heavy duty diagnostic applications for engines, transmissions, ABS and instrument clusters and much more. It supports virtually every standardized vehicle network protocol and nearly every software application in vehicle sectors like construction, agriculture, and of course heavy duty truck. Five times the speed of its predecessors with 16 times the memory, the USB-Link 2 is perfect for dealership, fleets, and truck shops. It speeds the repair times of these particularly mission critical vehicles and it improves technician productivity. It's a great upgrade to an already successful product from our RS&I group.

Also in the third quarter, our equipment division registered high single-digit growth with strong volume in North America, helping to offset the Russian market, which is our primary headwind in Eastern Europe.

Overall, undercar gains in the US were quite solid with especially impressive increased - sales increases at our Challenger Lifts division. Challenger has been a great addition to our Snap-on team and it improved again this quarter and we believe there is much more to come, helping RS&I to expand with repair shop owners and managers.

RS&I, great new product, with demonstrated growth in diagnostics, heavy duty and undercar equipment, and all of that played out in the third quarter results.

Well, that's the highlights of our quarter. Organic sales up 7.3%, gains across all groups, clear progress along our runways for growth. Snap-on Value Creation at the forefront of our activities, customer connection leading to innovation, creating powerful new products, RCI driving

improvement and it all shows in the results, OI margin to 17.5%, up 130 basis points. It was an encouraging quarter.

Now, I'll turn the call over to Aldo. Aldo?

Aldo Pagliari: Thanks, Nick. Our third quarter consolidated operating results are summarized on Slide 6. Net sales of $821.5 million in the quarter were up 7.3% organically. On a reported basis, net sales including $42.6 million of unfavorable foreign currency, increased 1.9%. As you know, Snap-on has significant international operations and is subject to foreign currency fluctuations. Largely due to the strengthening of the US dollar, foreign currency movements adversely impacted our Q3 sales comparisons by 570 basis points.

Net sales in the third quarter also included $2.1 million of sales from our July 2015 acquisition of Ecotechnics, a designer and manufacturer of automatic vehicle air conditioning maintenance equipment for OEM dealerships and independent repair shops.

Consolidated gross profit of $406.9 million increased $13 million from 2014 levels, primarily due to higher sales and savings from RCI initiatives, partially offset by 30 basis points of unfavorable foreign currency effects. The gross margin of 49.5% in the quarter improved 60 basis points from 48.9% a year ago.

Operating expenses were $263.3 million in both the third quarters of 2015 and 2014. The operating expense margin of 32% improved 70 basis points from 2014 levels, primarily due to benefits from sales volume leverage, partially offset by higher pension expense. No restructuring costs were included in operating earnings in the third quarter of 2015. Last year, we incurred $2 million of such costs.

As a result of these factors, operating earnings before Financial Services of $143.6 million in the quarter, including $11.9 million or 50 basis points of unfavorable foreign currency effects, increased 10% and, as a percentage of sales, improved 130 basis points to 17.5%.

Financial Services revenue of $61.1 million in the quarter increased 14% from 2014 levels and operating earnings of $43.5 million increased 15.4%. These increases primarily reflect the continued growth of the Financial Services portfolio.

Consolidated operating earnings of $187.1 million in the quarter, including $12.7 million of unfavorable foreign currency effects increased 11.2%, and the operating margin of 21.2% improved 160 basis points from 19.6% a year ago.

Our third quarter effective income tax rate of 31.6% compared with 31.8% last year. Finally, net earnings of $116.8 million or $1.98 per diluted share, increased to $13.1 million or 22 cents per share, representing a 12.5% increase in diluted earnings per share.

Now let's turn to our segment results. Starting with the Commercial & Industrial, or C&I Group on Slide 7. Sales of $288.5 million in the quarter were up 3.4% organically, driven primarily by high single-digit gains in both the segment's European-based hand tools business, and Asia-Pacific operations, and a double-digit increase in the segment's power tools operations. These sales increases were partially offset by a mid-single digit decline in sales to customers in critical industries, primarily reflecting lower sales to the military and to customers in the oil and gas sector.

Gross profit in the C&I Group of $109.5 million in the quarter decreased $2.3 million from 2014 levels, while the gross margin of 37.9% improved 50 basis points, principally due to savings from RCI initiatives and lower restructuring costs.

Operating expenses of $68.2 million in the quarter decreased $2.8 million from 2014 levels, and the operating expense margin of 23.6% improved 10 basis points from 23.7% last year.

As a result of these factors, operating earnings for the C&I segment of $41.3 million, including $2.9 million of unfavorable foreign currency effects, increased $0.5 million from 2014 levels, and the operating margin of 14.3% improved 60 basis points.

Turning now to Slide 8. Third quarter sales of the Snap-on Tools Group of $380.6 million increased 11% organically, reflecting continued double-digit gains in both the company's US and international franchise operations. Gross profit of $166.5 million in the quarter increased $11.7 million from 2014 levels and the gross margin of 43.8% improved 20 basis points.

Benefits from the higher sales and savings from RCI initiatives were largely offset by 110 basis points of unfavorable foreign currency effects. Operating expenses of $110.2 million in the quarter increased $4.9 million from 2014 levels, and the operating expense margin of 29% improved 70 basis points, principally due to sales volume leverage.

As a result of these factors, operating earnings for the Snap-on Tools Group of $56.3 million increased $6.8 million, and the operating margin of 14.8% improved 90 basis points including $6.8 million of unfavorable foreign currency effects.

Turning to the Repair Systems & Information, or RS&I Group shown on Slide 9. Sales of $282.9 million in the quarter increased 8.2% organically. The organic sales increase primarily reflects a double-digit gain in sales to OEM dealerships, a high single-digit increase in sales of undercar equipment, and a mid-single digit gain in sales of diagnostics and repair information products through independent repair shop owners and managers.

Gross profit of $130.9 million increased $3.6 million over 2014 levels. Gross margin of 46.3% in the quarter decreased 60 basis points from 46.9% last year, primarily due to a shift in sales that included higher volumes of lower gross margin products, including increased essential tool and faciliation sales to OEM dealerships, partially offset by lower restructuring cost.

Operating expenses of $61.2 million in the quarter decreased $2.8 million from 2014 levels. The operating expense margin of 21.7% improved 190 basis points, mostly due to sales volume leverage including benefits from the sales shift noted above.

Third quarter operating earnings for the RS&I Group of $69.7 million, including $2.2 million of unfavorable foreign currency effects, increased $6.4 million from prior year levels, and the operating margin of 24.6% improved 130 basis points.

Now turning to Slide 10. In the third quarter, operating earnings from Financial Services of $43.5 million on revenue of $61.1 million compared with operating earnings of $37.7 million on revenue of $53.6 million last year.

The average yield on finance receivables of 17.9% in the quarter compared with 17.6% last year, and the average yield on contract receivables was 9.5% in both years. Originations of $257.6 million increased 16.2% from 2014 levels.

Moving to Slide 11, as of quarter end, our balance sheet includes $1.53 billion of gross financing receivables, including $1.33 billion from our US Snap-on credit operation. Approximately 80% of our US financing portfolio relates to extended credit loans to technicians.

During the quarter, our worldwide finance portfolio grew approximately $62 million. As for finance portfolio losses and delinquency trends, these continue to be in line with our expectations.

Now, turning to Slide 12. Cash provided by operations of $113.7 million in the quarter increased $25.7 million from comparable 2014 levels, primarily reflecting higher net earnings in 2015 and net changes in operating assets and liabilities.

Net cash used by investing activities of $86.9 million included $55.9 million to fund a net increase in finance receivables. Third quarter capital expenditures of $18.5 million in 2015 compared to $22.3 million last year. Cash used in investing activities in the quarter also included $13.1 million for the acquisition of Ecotechnics.

Turning to Slide 13, days sales outstanding for trade receivables was 61 days at both quarter end and 2014 yearend. Inventories increased $52.2 million from 2014 yearend levels, primarily to support continued higher customer demand and new product introductions as well as inventories related to the Ecotechnics acquisition.

On a trailing 12 month basis, inventory turns of $3.4 million compared with 3.6 turns a year ago. Our quarter end cash position of $119.2 million decreased $13.7 million from 2014 yearend levels. The net decrease includes the impact of funding, $629.2 million of new finance receivables, the repurchase of 670,000 shares for $101.6 million, dividend payments of $92.5 million, and capital expenditures of $64.3 million.

These cash decreases were largely offset by $476.6 million of cash from collections of finance receivables, $352.1 million of cash from operations, net of $30 million of discretionary cash contribution to the company's domestic pension plans, and $39.7 million of cash proceeds from stock purchase and option plan exercises.

Our net debt to capital ratio of 25.7% compared with 26.3% at 2014 yearend. In addition to our $119.2 million of cash and expected cash flow from operations, we have more than $700 million in available credit facilities, and our current short-term credit ratings allow us access to the

commercial paper markets. At quarter end, we had $45.2 million of commercial paper borrowings outstanding.

This concludes my remarks on our third quarter performance. I'll now briefly review a few outlook items for the balance of 2015. We anticipate that capital expenditures in 2015 will be in the range of $80 million to $85 million, of which $64.3 million was incurred through the end of the third quarter.

We continue to expect our 2015 full year effective income tax rate will be at or below our 2014 full year rate of 32.1%.

Now, I'll turn the call over to Nick for his closing thoughts. Nick?

Nicholas Pinchuk: Thanks, Aldo. Snap-on third quarter, sales up organically 7.3% against some significant headwinds. Of course, as we say often, there will always be headwinds, always be challenges.

But in the midst of that, we believe our runways for growth are wide with abundant opportunities and you can see it in the operating groups. C&I in the center of the turbulence, sales up 3.4%, profits up 60 basis points. RS&I, wielding software and hardware with repair shop owner and managers activity rising 8.2% and OI margin of 24.6%, up 130 basis points.

Tools, an established and storied business, reaching higher, capturing more customers. Sales up 11% and a greater than 6% increase in 21 of the last 22 quarters. OI margin up 90 basis points despite 120 basis points of unfavorable currency.

And beside that growth, we see the effects of Snap-on value creation paving our runways for improving, helping to drive our op-co margin to 17.5%, up 130 basis points including 50 basis

points of currency headwinds. And rolling it all together with financial services, our EPS was $1.98, up 12.5%.

We believe that the third quarter results extending our positive trends continuing confirmation of the Snap-on possibilities for both growth and for improvement. And we believe as demonstrated this past quarter, we can continue on those positive runways as we proceed forward.

Now before I turn the call over to the operator for questions, I think it's appropriate to speak to our franchisees and associates. I know many of you are listening in again.

The encouraging results of the third quarter and our positive trends are a direct reflection of your capability and your effort. For the gains you've achieved, you have my congratulations. And for your commitment and your extraordinary contribution to our team, you have my thanks.

Now, I'll turn the call over to the operator. Operator?

Operator: Thank you. At this time if you'd like to ask a question please press the star and 1 on your touch-tone phone. You may withdraw your question at any time by pressing the pound key. Once again, to ask a question, please press the star and 1 on your touch-tone phone.

We'll take our first question from Bret Jordan with Jefferies. Your line is now open.

Bret Jordan: Hi. Good morning, guys.

Nicholas Pinchuk: Good morning.

Aldo Pagliari: Good morning.

Bret Jordan: A question on RS&I; you mentioned specific strength in undercar, a service chain reported this morning it had an 11% comp in alignment. Is there something structurally going on in that space driving growth or is yours tied to new product introduction?

You know, is this road deterioration, is it a secular shift or...

Nicholas Pinchuk: I think structurally - not something happened --I don't think this particular quarter. But I think structurally the whole automotive repair business is - got a nice tailwind in terms of changes in vehicles.

And in fact as you have more vehicles that want to do more things automatically, self-driving and so on, the precision of calibration becomes more and more important. And therefore the more accuracy and speed - more accuracy - things like alignment become more important and therefore the speed of that alignment becomes important, therefore the need for new products.

And so, I think it's nice times for automotive repair in general and in particular for undercar equipment. And I think...

(Crosstalk)

Nicholas Pinchuk:...ours being pushed by both at tailwind and some nice new product, that's in place as well.

Bret Jordan: Okay. And I guess, on that speed of change in technology - is sort of the next question. The software upgrade cycle as you were looking in the handheld units and replacing software, is that accelerating at all, or is the new code basically at the same cadence?

Nicholas Pinchuk: I think it's expanding. I think we're finding - I don't know, if we're introducing any faster necessarily upgrades, but I think the upgrades are more attractive. You hear me talk about

SureTrack and if I had a little more time to talk about VERUS Edge, I would talk about the fact that it has technical service bulletins involved.

And so, those products are more attractive and they're more liberating and they're more productivity advancing to customers and so that's driving part of that.

You can see it. You can see it - I'm sure, you've looked at the trends, and you can see that, I think the numbers are something like somewhere under 50% of cars today require, in all garages, require diagnostics repairs and all garages require diagnostics units, but something like 7 of 10 repairs in new cars require diagnostics units.

So you see a demand for that. And our software is the best available. One of the things you see in our - one of the things we're really excited about in our business when we did independent surveys of technician preferences, 63% said they preferred Snap-on diagnostics. Number two was 7%.

Bret Jordan: Okay.

Nicholas Pinchuk: Does it help?

Bret Jordan: Thanks. And one question I guess specifically to C&I on the US military, you talked about it being particularly weak. When they are weak, are they buying less premium product or not buying at all? I mean, are they going to Harbor Freight for what they would have purchased for you or did they just step out?

Nicholas Pinchuk: No. No. I don't think they are buying that stuff. I'm not sure, but I'm pretty sure that they are not buying the stuff, because you know when the .50 caliber bullets are flying overhead I think

this is the ultimate critical application and I don't think anybody wants anybody being disadvantaged under those circumstances.

So what really has happened by and large is the fact that there's uncertainty in where to deploy budgets around that. We've seen it before. Actually C&I, if you go back and look at the late - in late 2013, the critical industries, the critical industries again was bedeviled by a reduction associated with the military and that was directly associated with the word sequestration.

And so, you're starting to see those kinds of things now. In Washington people are talking about government shutdowns and so on and it's making the military nervous and they are spending less. We feel we're pretty well positioned though to take full advantage when they are ready to spend.

Bret Jordan: Okay. Great. So it's not trading down. It's just not spending.

Nicholas Pinchuk: No, no. Not in any significant way.

Bret Jordan: Okay, great. Thank you.

Nicholas Pinchuk: Sure.

Operator: Our next question comes from Liam Burke with Wunderlich. Your line is now open.

Liam Burke: Thank you. Good morning, Nick. Good morning, Aldo.

Nicholas Pinchuk: Good morning, Liam. How are you?

Liam Burke: Good. Thank you. Nick, you talked about railroad as being an interesting growth segment in C&I. Are there any other areas that saw particular strength during the quarter in the C&I?

Nicholas Pinchuk: Yes. Look, we were - amazingly, we're up pretty well in mining. Like I said, we're still starting to penetrate these things. So you can't - we're finding that we're affected sometimes by - somewhat by the environment, but not - we can overcome it at times and mining was one of those.

Heavy truck was up fairly well in the quarter. So that was a good entry. General, if you just look at general production, the kinds of stuff, the things that are associated with grinders and so on, we had that kind of thing. So I mean we had some fairly reasonable positive points, the US aviation, the aviation in US was okay, that kind of thing.

Liam Burke: Okay.

Nicholas Pinchuk: So we had some positives. And we had oil and gas, international aviation and the military which were negative.

Liam Burke: Okay. And with your van channel being supported now with Rock N' Roll vans, are you seeing any step up in average ticket item per franchisee during the quarter?

Nicholas Pinchuk: No. Big ticket was still reasonably strong, but I think we're not seeing any particular, if the question is associated with the rise in the size of the - let's say the purchases, the size of the purchases, I would say no in the quarter necessarily, not anything particularly big in the quarter.

Nothing that would change the trend. We're still seeing a robust demand though for things like tool storage and of course our diagnostic units and other things that we would roll into big ticket.

Liam Burke: Great. Thank you, Nick.

Nicholas Pinchuk: Sure.

Operator: Our next question comes from Gary Prestopino with Barrington. Your line is now open.

Gary Prestopino: Hi. Good morning, everyone.

Nicholas Pinchuk: Good morning, Gary.

Gary Prestopino: Couple of the questions have been answered, particularly on industrial. But let me just ask in terms of seeing pretty good growth year-over-year in the credit portfolio, is that still indicative of that there is a healthy appetite for the tool boxes, bigger ticket items?

Nicholas Pinchuk: Yes, there's a healthy - I think there's a healthy attitude, generally it directly reflects the motion of the Tools Group in general. If you look back at originations and look at Tools Group growth over the last three quarters, they're sort of the same, so that's pretty much what's driving it.

I think it's not just tool boxes though, you get - you will get things like - you get things like big diagnostics like the VERUS Edge. I mean, the new VERUS Edge is a product that will run in several thousands of dollars and that can be financed on that kind of thing.

So, you will see a number of things like that. So, it's not just tool boxes, but it is - the big ticket items were, I think this quarter just slightly below, somewhat below the Tools Group in general, but over three, four quarters has been better than the Tools Group.

Gary Prestopino: Okay. And then in terms of the Rock N' Roll vans and the TechKnow vans, are you at capacity where you want to be right now in the US?

Nicholas Pinchuk: I don't know. I think Rock N' Roll Cab, I think we added like maybe like five in the last quarter in the TechKnow vans and we didn't add any Rock N' Roll cabs. Rock N' Roll cabs have been solid for some time. Having said - been the same number for some time, but, you know, I wouldn't necessarily sign up to the idea that I wouldn't add more going forward. Rock N' Roll cabs were introduced somewhere in 2011.

And I have to tell you, Gary, we've been learning about how to use them better and how effective they are and where they're most effective and how to do that each quarter. But for now, they're pretty much where they're going to be. The TechKnow is something else.

So we've added quite a few. I think actually year-over-year for TechKnow, we've added 21 TechKnow vans, and I think we'll be probably trying to see how that 21 plays out for a little while, and then we'll make a decision whether we need more or not going forward.

But it's a mistake to think that tool storage sales is directly proportional to the number of Rock N' Roll cabs, that's not true. What we found is they've gotten more and more and more productive, more and more liberating every time, every quarter, and same thing for TechKnow vans.

Gary Prestopino: All right. Well, it basically expands your store for selling space, right?

Nicholas Pinchuk: Correct, it does. But then we find out how to - then actually what we find out is how to amplify the Rock N' Roll space. I mean, it's kind of a multilayered thing. It does help that though. I mean in one sense it expands on a time-sharing basis the space.

But the effect of that space, I would say over the four years we've had it, the ones that we installed first are helping a lot more than they did when they first occurred.

Gary Prestopino: And last question. Is this just the US phenomenon or is this in other countries where mechanics own the tools that you have these kind of vans?

Nicholas Pinchuk: It's in other countries. I mean, I think, I guess we have seven international Rock N' Roll cabs, and so we've used them in different places, things like the UK, in Canada, and some in Australia. And we've just started to do that for the TechKnow vans. So it's a phenomenon that can work in other places.

Gary Prestopino: Thank you very much.

Nicholas Pinchuk: Sure.

Operator: Our next question comes from David Leiker with Baird. Your line is now open.

David Leiker: Good morning, everyone.

Nicholas Pinchuk: Good morning, David.

Aldo Pagliari: Good morning.

David Leiker: So a couple of things, back on C&I. You know, that's a business - you've got three or four different buckets of businesses within there. It tends to be a little bit lumpy quarter-to-quarter. It's kind of a strange question, but is there any way or anything that we from the outside should look at to try and get a better handle on what the quarter-to-quarter trends are going to be there?

Nicholas Pinchuk: I don't really have - the thing is that - the truth is, sure. What we know is the industry problems, the economic environments create an overhang. And then in places like, for us and you see it in oil and gas this time, you can see it in mining, although mining was a contributory for us.

So it's very difficult to look at any macro and say it's going to affect us. All you can say is look, the general macro is going to create an overhang. How well we do in offsetting it is another question, but we do have the ability to offset it from time to time.

Like in this quarter, we felt, we feel when we look at Industrial, when we look at critical industries, we feel we can see the trajectory of upward trends even though it was a tepid quarter, it was a drag on us this time, because we can see the gains in railroad, in places like mining and heavy duty.

So we can see the proof-of-concept working through. It's hard for us to give you any guidance on that. In Asia Pacific, for example, the turbulence around Asia Pacific didn’t really create an overhang for us, but we succeeded in some markets and had some difficulty in others.

Our operations and our sales in both those markets ended up being a growth situation. In Europe, it seems like, and I think what's worked for us in Europe is we came from such a low position. We kept investing. We create new product that we're growing even as the market is tepid. So it's kind of a cocktail of things that I can't quite give you any particular macro on which to trend.

David Leiker: Yes, I...

Nicholas Pinchuk: All I can tell you is I think we feel progress in each of those places.

David Leiker: Yes, I just figured that was the answer. On Asia Pacific...

Nicholas Pinchuk: Yes.

David Leiker:...that business over the years, you've continued to see strong growth on the automotive equipment side of that business. What's the makeup of that revenue today between equipment versus the critical industries versus other pieces?

Nicholas Pinchuk: I don't really have the percentages for you. I will say that you're right in saying that equipment is probably the biggest piece of that, and then you've got cutting tools, which are another piece of it, which are primarily industrial based. Industrial based tools are another piece, and then what's after that, it would be, I'd say, the critical - we call them - in that orb we call them premium tools, like the Snap-on tools sold into the super-premium applications like Thai Airways and things like that.

We actually had a pretty good quarter with those in places like Singapore and Hong Kong. And the equipment actually was one of the things that drove us into Vietnam. We're actually pretty pleased about Vietnam. I've been waiting for Vietnam to give us some daylight for some time, and this is the quarter which it kind of worked. So it was an encouraging event.

David Leiker: Great. And then one last item here on margins. You guys did a great job of continuing to drive value and drive margins with the RCI activity and the focus and execution.

Are you doing anything beyond what you normally do, cost cutting or pulling back on discretionary spending or anything along those lines, belt tightening with some of the uncertainties going on around the world?

Nicholas Pinchuk: No. We're not doing anything like that. I mean, I suppose it's kind of dumb thing for a guy like me to say that, but the fact our - we - okay, people here are shaking their heads, yes, that is dumb. But, okay.

David Leiker: So am I.

Nicholas Pinchuk: But it’s true. We believe in our runways for growth, and we continue to invest in them. The profit improvements you are seeing, the 130 basis points, have nothing to do with restriction, nothing.

David Leiker: Okay.

Nicholas Pinchuk: Because we don't see it that way. Of course, there are headwinds and they might impact us, and I never said we would keep going, marching upward every quarter. It's almost impossible for anybody to do that, although we have.

And so we just believe in the future of extending to critical industries, enhancing the van channel, expanding with repair shop owners, and in emerging markets, so we keep investing in it.

David Leiker: Okay. Perfect, great. Thank you very much.

Nicholas Pinchuk: Okay.

Operator: Our next question comes from David MacGregor with Longbow Research. Your line is now open.

David MacGregor: Yes, good morning, everyone. And Nick, congratulations on a great quarter.

Nicholas Pinchuk: Thanks.

David MacGregor: Let me start off with just continuing on the point we were just discussing, and you talked about the fact that there wasn't a lot of belt tightening in this, but then you cite RCI progress in each of the individual segments. So let me reconcile this.

It seems as though there has been some cost cutting. I'm looking specifically at the C&I segment, where you had a negative 5% incremental margin. In other words, revenues were down, but EBIT was up. And I know you've said repeatedly in the past that your RCI would allow you to grow margins in a flat revenue environment. Help me understand the answer you just gave to the last question versus these points.

Nicholas Pinchuk: Sure. First of all, first of all, we view -- you may not like this either, but we view as-reported sales as arithmetic. Organic sales are up for us, so the bits and the bytes and the metal and the mechanisms, we sell more of that we're happy. We're encouraged by that. So even in C&I, which was down, that 3.4% organic is what we follow because that looks to us to be customer gain. That's one.

Two is, is that what you see in this situation is when I'm talking about RCI, I'm talking about things like being able to make the product less expensively. We reduce the set-up times in the factory, which is a big deal for us. We find ways through customer connection and our innovation process to wield new technologies that allow us to develop new product cheaper.

Remember, in C&I, for example, last year in aviation, we brought - last year, in oil and gas, I think we - for heavy truck, let's say, we brought out 859 new products, and aviation was 996.

And one of the things that allows us to make to do that better is new technology like 3D printing and finite element analysis and so on. And that cuts cost in the design cycle and allows us to bring out those new products with lower cost than before. Those are the kinds of things we do.

David MacGregor: Okay.

Nicholas Pinchuk: And even if we have - so, even if we have lower as reported revenues, our cost gets driven down because of some of that. And it doesn't happen every quarter, if it happens - if I reduce the cost of one particular product, well, maybe that product sells well this quarter and I get some good benefit out of it. That may not sell so well next quarter and I don't quite get the same benefit.

David MacGregor: Okay. I appreciate that clarification.

Nicholas Pinchuk: Okay.

David MacGregor: Yes, I appreciate the clarification. Thanks. On the originations, it's up 16%. Once again it's kind of an up 9% number last quarter. Is that really just timing?

Nicholas Pinchuk: Yes, it's pretty much. Yes, there's a lot of timing flowing through. Remember that originations have to do with the franchisees selling the products.

David MacGregor: Right.

Nicholas Pinchuk: Right. And you also got an SFC that flows through this. So, in originations are things like loans that go through for the franchisees themselves, like van loans and things like that that occur. And so there's that noise in the originations in the month.

So when we have a particularly great SFC that can distort that as well. But when you step back and you look at the trend of everything, it really is - there is a lot of noise from quarter-to-quarter. You've kind of got to look back. And if you look at three quarters, you'll see it's pretty close to the same, between Tools Group growth and originations, pretty close to the same and if you say that Tools Group big ticket grew faster, it makes sense.

David MacGregor: Okay. Military and oil and gas, is there any way you can size that up for us as a percentage of critical industries...

Nicholas Pinchuk: Okay. I'll try this - how about this one. You know, we mentioned like five segments, six segments in critical industries, and the military is a big one, it's the biggest because we entered there first, because it made sense. Just as I said before, when the bullets are flying overhead -- I can assure you this from personal experience, when the bullets are flying overhead, people kind of want to make sure things work. And so we figured it was the most critical of industries. We invested in it and it warrants bigger. So if you take our revenues which is somewhere north of $450 million or something like that let's say, and you divide them by six and you take one of the bigger ones, that would be the military.

And oil and gas would be more in the middle some place. So that helps. I think that should give you some ballpark view of this. You got one big guy who is down strong double digits, it can put a little over hang on you.

David MacGregor: Okay. Let me just ask one last question, just relating to the call here and just kind of a big picture high level question, but if you could just walk us through with some quick comments on each of the four segments.

You just discussed recessionary environment, how much downside would you expect in revenues? And also, I guess, with all the progress in RCI initiatives and the new product

introductions and the much richer portfolio, how much better, if at all, would margins be in the trough than what we saw last time around?

Nicholas Pinchuk: Last time around we started at 12% and went to 10%. The 12.3%, if I remember 2008, the OI percentage was like 12.3% and it went to 9.9%.

David MacGregor: Yes.

Nicholas Pinchuk: And that was - the 9.9% was, I would say, artificially depressed by the fact that we had the credit company in transition, somewhat, not huge, but that's a factor there a little bit. And so, you can say, all right, it impacted some, but maybe not much, but okay, we had that transition going on in Tools Group and so on, maybe arithmetically it didn't affect it, but down there, we had some turbulence. And so then the big difference there now is we're starting at 17.5%, all right. So I mean, I wouldn't expect it to be worse than that duration.

The other factor I'd offer is this, is I believe - two factors. One is, I believe we are stronger in our market positions, therefore even more resistant, number one. Number two - number three, and this is harder to predict, last time, our customer base, which was principally the - 70% of the customer base, the automotive repair technician, I spent a lot of time talking about the fact that they were cash rich and confidence poor, they were getting up every day and reading bad news for breakfast. It was the worst recession of our lifetime. People were talking about putting dollars in mattresses. Well, I'm not sure - and so therefore they didn't buy big ticket items even though they had a lot of cash.

That would happen again, but I'm not sure it'd be the same extent. I don't know. That's a judgment call of course. And one more experience at RCI than we were. And the other thing is, we're just better at RCI, and so we probably step that up.

If you can't, you only have 24 hours in a day, so if you can't - if you think the prospects for growth are less, you turn more toward improvement.

David MacGregor: That's really helpful. Thanks a lot.

Nicholas Pinchuk: Sure.

Operator: Our next question comes from Tom Hayes with Northcoast Research. Your line is now open.

Tom Hayes: Thank you. Good morning, gentlemen.

Nicholas Pinchuk: Good morning.

Aldo Pagliari: Good morning.

Tom Hayes: Just as it relates to the Tools Group, certainly positive results from both the domestic and international businesses. Nick, I was wondering if you could maybe give a little additional color in regards to the contribution for the international franchise business in the Tools Group.

Nicholas Pinchuk: The international franchise business is about - is also up double-digits. The US is up strong double-digits, the US is up, the international is up just about the same. I would say that in order the strength, Australia and UK were actually up more than the US, Canada was up somewhat less, so you put those together in a cocktail and I think it all came to about the same as the US.

Tom Hayes: Okay. And then I guess looking a little bit of bigger picture, I think you've kind of touched on some components so far today. Clearly, an opportunity for you is to get a larger percentage of the

shop related spending. Just what are your thoughts on where you are on the penetration rates when you look at complete shop spending and some of your initiatives to expand that?

Nicholas Pinchuk: Well, let's look at it this way. I think I would say that we are less than half of where we are in terms of our position with tools. And so, if you think of it that way, yes, people respect our brand, shop owners respect our brand as much as technicians. So I would view that as kind of an - view of the opportunity. We think we have runway in the tools itself for the technicians and we're well behind that in terms of shop penetration. So, I think we've got quite a bit of runway there. I would say, you know, if you want to use baseball terms, we're in the third or fourth inning.

Tom Hayes: Great. Thank you.

Operator: And it appears we have no further questions at this time. I'll turn it back to Leslie Kratcoski for any closing remarks.

Leslie Kratcoski: Thanks everyone for joining us this morning. A replay and transcript of the call will be available shortly on our website. And as always, we thank you for your interest in Snap-on. Good day.

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