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# EDITED TRANSCRIPT

SNA - Snap-on Incorporated at Robert W Baird Industrial Conference

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## CORPORATE PARTICIPANTS

**Nick Pinchuk** *Snap-on Incorporated - Chairman and CEO*

## CONFERENCE CALL PARTICIPANTS

### Operator

**David Leiker** *Robert W. Baird & Co., Inc. - Analyst*

## PRESENTATION

**David Leiker** - *Robert W. Baird & Co., Inc. - Analyst*

Good morning. My name is David Leiker. I lead the team at Baird that follows the global auto and truck markets. Our next presentation is from Snap-on.

The Company is a provider of tools, equipment and technology for automotive repair markets with a strong and growing presence in supplying the industrial tool market and addressing the emerging markets. Investments in new product development, extension in these markets and continuous improvement actions are expected to drive earnings higher over time. Representing Snap-on are Nick Pinchuk, Chairman and Chief Executive Officer; Aldo Pagliari, Senior Vice President, Finance and Chief Financial Officer; and Leslie Kratoski, Vice President, Investor Relations.

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**Nick Pinchuk** - *Snap-on Incorporated - Chairman and CEO*

Hi. I'm Nick Pinchuk, and I'm representing Snap-on. It's an interesting company. Pretty unique in terms of having a great legacy of innovation and pride that carries on today. It's got some great strength in its brand, legions of loyal customers and what we think, has some abundant runway going forward, runway for improvement, improving our operations, making better and runways for growth. I'll talk about that.

Here is the Safe Harbor, I'll let you look at it. That's enough. Okay. Snap-on. This is our overview. Snap-on was founded on pride and innovation. It's worth telling the story. 1920, an engineer gets an idea. The auto industry was started. He gets an idea how to revolutionize tools. Five handles of different sizes. You can see them here in this photo. He puts them together with 10 sockets of different dimensions and he [fashions] them so they snap on interchangeably. It revolutionized the industry. It was an innovation that everyone recognized.

But it is something else that was also great and probably even more brilliant. He asked the salesmen to go directly to mechanics and when they sold the tools, to lay them out on green felt as if they were as precious as surgeon's knives, implying that the mechanic was as high a form of craftsman perhaps as a surgeon. Therefore, implying and setting the tradition of Snap-on of pride in what you do as a working man or woman by ownership of the tools.

And that idea of innovation and pride has been with us for these 92 years until we've grown to be about 11,500 employees, \$3 billion of sales, \$4.5 billion of cap. Depending on the day, you look at the stock market and a 2% dividend, which we have paid every quarter since 1939 and we have never reduced it. It's just a little bit of a summary of what I've said.

Snap-on operates in criticality. In other words, when repeatability and reliability are absolutely necessary, Snap-on is so often the choice. We're not just an American company, we're in 130 countries and even today, pride is part of our business. We have people in downtown dealerships around here that are wearing Snap-on jackets around because they're proud to have Snap-on jackets on their chest, Snap-on logo on their chest and they paid for those jackets. They weren't free.

Here is how we're organized. We're organized facing three big customer bases. One, the red, what everybody thinks about which Snap-on, these are the vans, 3,471 of them, crisscross America and they sell tools directly to mechanics, the people who twirl wrenches, 35% of our business. To the left dark blue, Repair Systems and Information, 27% of our business. They sell to a co-located, but different customer base. The repair shop

owners and managers, a different type of buy, a different sale. A credit company, which represents 4% of our business, which supports those two sectors. And then the light blue, which is 34% of our business, which focuses on critical industries like aviation, education, military, oil and gas, mining and so -- and power generation and emerging markets. That's where we focus on.

Now we have other brands. A lot of people think that we're just Snap-on, we're a branded house. Well, that isn't really true. We have other very strong brands. For example, in Europe, we have a brand called Bahco. In some countries in Europe, you want an adjustable wrench, people say, give me the Bahco.

We have Blue-Point, which is around since 1920 and has a great reputation. We have John Bean, which is the original four-wheel drive, the founder of four-wheel drive or four-wheel vehicle alignments. Hofmann, which is another under car brand that's got great brand position for tire balancers and aligners. And Mitchell1, which is a software brand for repair shop management and repair information on how to actually repair the cars.

And then we just still make hand tools although we make the best ones. Pick up a Snap-on wrench, it's really good. But we also make power tools and torque wrenches and aligners and lifts and all kinds of software, electronic parts catalogs, repair shop management, suites of software and just the idea of things that'll -- diagnostics, which are electronic laptops for cars and tell you how to fix the car and the software that will give you the tips to fix that car, the special tips that will fix the car.

We're not just in America either anymore. You look at this, we are -- a big portion of business in America. North America, what is it, 66%, Europe is 22%, Asia Pacific 10%, and the rest of world I guess is 2%. So that's what Snap-on looks like today.

Looking forward, this is what we say. Looking forward, we do what we've always done. The world moves forward and Snap-on actually eases the way with innovation and gives pride to its customers. We do this in a couple of ways. But the first way moving forward for our Company is what we call runways for improvement. These are processes which we believe in. And we call them the Snap-on value creation, a suite of processes around safety, quality, customer connection, innovation and rapid continuous improvement, other people call it lean or kaizen and they have worked to make our Company better.

If you look at our financials, you can see and you can start to believe that we can make more money on flat sales every single year because of Snap-on value creation. A few examples of this, I'll go through them. Safety. Now you might say, well, how's safety important? It's important for your own productivity and if you make hand tools for working men and women, you can't keep your own people safe. There's some problem with that. And I'm proud to say that this year, a Snap-on associate is 91% less likely to have an accident than just in 2006.

Quality, didn't take process, the word process to [doing on] Snap-on to have quality at Snap-on. But we've been bringing good statistical process control, good modern methods to make quality repeatable and reliable at Snap-on and it's been working and the best measure of this, there's not so much things like factory critical defects, it's asking our customers. And we asked our customers again this year. We asked Frost & Sullivan to do this. What's your preferred form of tool? What's your preferred tool?

When we asked about hand tools, 80% said Snap-on. The next highest number was 6%. When we asked about those laptops for cars, diagnostics was 57% -- 59% to 17%. When we asked about tool storage, it was 65% to 13%. These are overwhelming -- this is overwhelming testimony that we think that Snap-on quality is alive and well and getting better.

Then we talk about customer connection. This is observing work and getting information from it. And we're in more workplaces than most other companies, almost any other company. 4,800 vans around the world visit mechanics every week. The same mechanics every week, they're just making their route every week, 4,800. We have several direct sales forces, hundreds of direct salesmen. We're in 600,000 repair shops in North America and Europe. We're in 2,500 technical institutions, technical schools where Snap-on, where students are becoming Snap-on customers for life. And we have a special facility at Kenosha Snap-on where customers come in, work on products and we observe them and try to figure out how to make the work easier, 12,000 visitors in just a couple of years it's been around.



And it's been working in terms of innovation, because if you want to measure it by awards, we got awards from the Motor Top 20. We had three awards this year for the Motor Top 20. The Professional Tools & Equipment News Innovation Awards, we've got a couple of awards there. The Undercar Digest the Top 10 Awards, we've got a couple of awards there. We've got red dot awards for design in Europe and awards are great.

But for me, what's important is, do we launch new tools or create excitement? And our measure of excitement is to sell \$1 million. And the number of tools that have sold \$1 million has been going up dramatically. In fact, last year it was six or seven times as many of those tools, those hit tools as just in 2006. So this process is working.

And then we go to rapid continuous improvement. We have full-time rapid continuous improvement people at every site, every site around the world. They get up every day and think about how to create energy around making jobs more efficient and productive. And then our team, our management team goes out once a year to a factory and this year we're going to visit Elizabethton, Tennessee; last year we went to Conway, Arkansas. A year before that Vila do Conde, Portugal. Year before that California and spent a week on the factory floor, helping to improve that factory. We learned a lot about factory operations.

We advanced our understanding of kaizen, but we also demonstrate how important it is to the organization and all of this is working. Snap-on value creation is working and here's the evidence. 2007 and 2011 sort of the same sales, \$2.84 billion, \$2.85 billion, but the profitability goes from 10.6% to 13.5%, 290 basis points improvement on the same sales because of the Snap-on value creation. So runway for improvement, we think we have more to go. We've gone down some, we have more to go.

Then we say, if we look forward, we also have runways for growth, enhance the van network, expand with repair shop owners and managers, extend critical industries, and build in emerging markets. Let's think about the industry we're in. Remember that pie chart I showed earlier with the van business and the repairs -- RS&I business, repair shop owners and managers business and the critical industries business, if we map that on to an industry chart, it shows that 70% of our activity is in automotive repair, vehicle repair actually, 30% in other industries. Is that a good business to be in?

Well, global vehicle population, we reckon, is going to grow at 3.9% per year for the next five or six years, up to 1.2 billion in the United States. Vehicles are aging. 46% are over 10 years old now. I think another 24% is between seven and 10. The average age is like 11.5 years and then we've gotten older every year since 1980. In big new car sales and low new car sales that get older. If you're into repair, this is good.

Then vehicle technology. One of the things about vehicles, if you look under the hood, they keep changing. So look under the hood of about, say, a 2000 model and you look under the hood of your 2012 model or 2013 model, you'll see big difference. So you need different tools to deal with them. If you could see the electronics, you would see that the number of systems has increased exponentially. There is now re-programming. So if you change the battery, you got a re-programming alternator. And on top of this, there are new technologies. We love it when we hear people are going to adopt hybrids and electric cars because it requires different tools. So this is good for us.

Then another one, a little more subtle is this. Independent garages are growing in share. Consider a dealership. A Ford dealership or -- I just visited last week with a franchisee, BMW dealership. What are they working on? What are those technicians working on? They're only working on Fords or BMWs. And they're only working usually on the ones that are still on warranty. And so in a dealership, the repair task is more narrow, same badge, smaller number of years. When he plugs in, when a technician of BMW dealership or the Ford dealership plugs in a laptop for his car, or Toyota, we provide the laptop, but the information is given to us by Toyota or Ford because they have all the decoding information and the repair information. And that's how it works. But if you go to an independent garage, they got to be ready to work on maybe 30 badges and maybe 15 years and when he plugs that laptop in, he's got to be able to read them all and we have that information.

And by the way when he has to deal with the tools, when he has to work on the car or even change the oil, he may need different tools for an Audi or a Ford or Chevrolet over the years, a broader array of tools. So independent repair is good for us and that's been increasing 68.8% in 2006, the repair dollars, the share of repair dollars in independent garage is 68.8% in 2006. This year we estimate it at 73.5%, a good trend for us.

So we're going to try to work to enhance that franchise network because it calls on this space. We're making sure they're healthy. Our franchise, they have never been stronger in terms of balance sheet. They've never been better in terms of turnover. Our turnover is as low as it's ever been.

Their productivity is going up, so they can reach more customers and we're figuring out how to help them sell to more customers. This particular van business has increased in this environment, double digits for the last nine quarters in the United States.

Now Snap-on's tradition has always been hand tools through vans to auto mechanics and we did it really well. But actually when we thought about it, this is a narrow description of what we actually do. What we actually do is, we make work easier for serious professionals, not for amateurs, not for DIY people. We don't sell DIY. As long as they operate in criticality, which means that the penalty for failure is high enough that it justifies the need for repeatability and reliability that justify Snap-on level premiums.

And so that gives us a whole other set of customers, repair shop owners and managers. They respect it as much as the mechanics, but our share isn't as good with them because we never focused on them. So we have technology leadership in that area. We can sell more to them. We have proprietary content in the repair information we have. And we have sales forces already in there. We can call in the air strikes. That's a good opportunity for us, a good runway, extend to critical industries. Another word for this is, we like to say, roll the Snap-on brand out of that garage to places where the penalties for failure are high and they need repeatability and reliability. By the way they already respect the Snap-on brand. When you walk into an aerospace facility with the Snap-on head-on, you are greeted with respect. And so it's a natural extension from us and this business has been growing at double digits.

And then build in emerging markets. It's interesting story. If you're selling new cars today, China bought about 25% more -- 25% to 30% more new cars than North America. So it's your biggest market, but not so for us. You see because in the United States there are roughly 300 million light vehicles on the road and they're old, 11.5 years old. And so these are the metrics, which require 300,000 shops and 1.3 million technicians. But in China, despite the fact they sold 25% more new cars.

There may only be 65 million vehicles on the road and they're all new. And that can be fit for power generation or airframes or mining equipment. So the repair wave hasn't quite started there yet. What we're doing is positioning ourselves to take advantage of it. So in 2003 in China -- in Asia outside of Japan, we had two offices and 10 people. Now we're -- I lived there, I lived in Asia 11 years myself. I know how this works, building the physicals to take advantage. And so we're building the physicals. We now have not two offices and 10 people. We have 30 offices, 1,500 people, four factories, a design center, a wide range and growing range of product and hundreds upon hundreds of distributor partners. So those are the runways for growth, enhance the van network, expand with repair shop owners and managers, extend the critical industries, roll the Snap-on brand out of the garage and build in emerging markets.

And this whole thing has been working over time. If you look at the numbers, we started to grow \$2.3 billion, \$2.5 billion, \$2.8 billion -- \$2.8 billion and started to get the recession. We go down at \$2.6 billion -- \$2.4 billion, then \$2.6 billion and build back up. But look at the profitability, 6.5%, 7.6%, 10.6%, 12.3%, we hit the recession. We kind of almost hung on to that double digits, 9.9%, then 12.1%, 13.5% again. So you see Snap-on value creation and the runways for growth working.

One other thing we did in the middle of 2009. We always had a -- at least in recent memory for Snap-on, we had a 50-50 joint-venture with CIT providing credit. So our credit company, providing credit for the vans, the van drivers. There was a little bit of turbulence, you might remember with CIT in 2009. And we ended up deciding to bring the credit company home. What this meant was, we got to bring the -- all the credit assessment and the writing of the paper and the collection activities home in-house. So all that SG&A, but our portfolio was on CIT's book, or on the joint venture's books. It was on the CIT's books because that's how the joint venture works. It would give the -- sell the paper to CIT. So we had an operation with really little loan portfolio. A big operation.

And so in the first quarter, in the third quarter of 2009, you can see the number, \$255 million loan portfolio and we lost \$5.3 million. A year later, we were at \$667 million and were making \$5 million. This last quarter, which we predicted by the way, we're seeing, we're bringing, we're building the portfolio and making important profit. We predicted this would happen, it's nothing extraordinary I guess, just over \$1 billion, \$1.62 billion and we made \$27.9 million. Of course, this is before interest charges, this is operating income. But it gives you an idea of the rise of the profitability and how it occurred if we brought it in-house. So the credit company is a good opportunity for us.

Now let's talk a moment about the third quarter. Look, the third quarter was I would say encouraging for us. The organic growth around the Company was 4.6%. The earnings per share grew from \$1.16 to \$1.26, but the earnings line does not tell the whole story. The credit company



moved up, but if you look at the operating company, you have to realize that our stock grew in that quarter and we had a mark -- unfavorable mark-to-market effect year-over-year. It was worth for us \$12.2 million in the quarter.

So profitability increased without this [slight] between 20% and 25%, and the OI for margin increased 170 basis points in the third quarter. We thought it was encouraging. So that's our story. Snap-on is a -- is, I think, fair to say a unique company. And by the way, I'm not a lifer. So I don't have any -- I've only been here 10 years. So I don't really have any responsibility for having built up the brand name or the legions of loyal customer, anything like that, I inherited at my good fortune. But in fact, it has some great strengths, legions of loyal customers and a history and a legacy and a reality of pride and innovation.

And what we believe and we can see as that this Company has great runways in the future, runways for improvement, because the processes in Snap-on keep showing the improvement in safety, quality, customer connection, innovation and rapid continuous improvement. You can look at our numbers and it appears we can go up without sales increases, 170 basis points in the third quarter. And then runways for growth. We have these re-imagination of the corporation, not a corporation that sells tools through vans to auto mechanics, but a corporation that makes work easier for any serious professionals as long as they operate in criticality and that brings new customers to us, growing coherently in doing just what we've done before and that's our story. Snap-on, great strength, pride and innovation, runways for improvement and runways for growth.

Now I'll take any questions.

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## QUESTIONS AND ANSWERS

**David Leiker** - *Robert W. Baird & Co., Inc. - Analyst*

(inaudible) for the audience.

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**Nick Pinchuk** - *Snap-on Incorporated - Chairman and CEO*

Sure, sure. Any questions?

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**David Leiker** - *Robert W. Baird & Co., Inc. - Analyst*

Let me start and talk about a little bit on the --

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**Nick Pinchuk** - *Snap-on Incorporated - Chairman and CEO*

I can talk about the election if you'd like. Go ahead.

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**David Leiker** - *Robert W. Baird & Co., Inc. - Analyst*

Let's stay away from that topic. As we look at the margins and the improvement in profitability, I know you've raised your target for product margins some years ago to the mid-teens, excluding the credit company. And you're getting close to that level. At what point do you think you update that or revise those expectations?



**Nick Pinchuk** - *Snap-on Incorporated - Chairman and CEO*

Well, David's asking we -- when are we going to raise our target for -- our target at least enunciated has been mid double digits, which I think most people are interpreted to be 15% and we're now getting toward that target. Now we set that target. I think it was 2005 or 2004 when our number was 5.9%. I mean maybe people kind of took it with a grain of salt and we've gone with relative regularity moving toward that.

What we said is we're not going to raise it until we actually get over the hump on that for a year. But I've also added and I believe this to be true. Sort of rooted in what I said, Snap-on is an unusual property rooted in criticality and enabled by process and by great strengths in the marketplace and devotion of working men and women that are not just in automotive repair. We believe it can be among the most profitable of industrial companies. We would be disappointed in ourselves in our capabilities and we do not think we are incapable if we didn't think we could do that. I leave it to you to figure out what that number is.

Any other questions?

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**David Leiker** - *Robert W. Baird & Co., Inc. - Analyst*

(inaudible).

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**Nick Pinchuk** - *Snap-on Incorporated - Chairman and CEO*

Okay. Oh, sorry.

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**Unidentified Audience Member**

(inaudible - microphone inaccessible)

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**Nick Pinchuk** - *Snap-on Incorporated - Chairman and CEO*

No, it's --

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**David Leiker** - *Robert W. Baird & Co., Inc. - Analyst*

Can you repeat that, please?

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**Nick Pinchuk** - *Snap-on Incorporated - Chairman and CEO*

Sorry, yes, sure, right. The question was how do we think of the finance company. It's provided profitability tailwinds, but it has eaten cash over the last several quarters. How do we think about it? Do we think about it as a standalone company or as an integral part of Snap-on? The short answer is we think about it as an integral part of Snap-on. We viewed the credit company as the largest acquisition we ever made, it's \$1 billion -- it's a \$1 billion worth of assets. For us that's a big acquisition. If we had screwed it up, people would have been excited, right.

And so, we had all the questions of having to bring this on board, make sure it worked and what do these six -- we had approved that these six from Kenosha knew what they were doing in the credit world. And I think we have and what it is, is actually it is -- it has actually enabled some of that nine quarters of double-digit growth for the tools group because it works hand in glove now with the tools group more effectively and we don't -- a 50-50 joint venture doesn't work as closely with an operation, it's consolidated as something that's inside. We found that out and it isn't doing anything, I think, highly risky or anything, but it is working with more cooperation and helping drive that growth. And so it is strategically inside the Snap-on business.



And we don't see ever turning it to something else. We're not going to see us talk about things like financing mobile homes or something like that. We're going to keep it in the -- aimed at the right at this strategy. So it will grow roughly as the tools group grows.

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**David Leiker** - *Robert W. Baird & Co., Inc. - Analyst*

I mean I had a editorial comment that pre-tax return on assets for the business is 4%. So what kind of leverage you want to put on it, it's a pretty good return on equity? All right. Nick and the management team will be available for a breakout down on the Eighth Floor in the Oak Room. Please join me in thanking them for the presentation.

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**Nick Pinchuk** - *Snap-on Incorporated - Chairman and CEO*

All right. Thanks.

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