Company Name: Snap-on Incorporated (SNA)
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<<David Leiker, Analyst, Robert W. Baird & Co.>>

Good afternoon. I'm David Leiker. We're going to finish the day with one of our favorite business models, Snap-on. The Company was founded in 1920. We estimate sales in 2015 could approach $3.5 billion, with EPS growth of 10% to 15%. Since 1991, full-year sales have declined only twice. Snap-on makes and sells tools, equipment and diagnostic technologies for a professional automotive repair market, and also has significant presence in the industrial tool market. We look for market share gains, deeper market penetration and growth in the emerging markets, along with continuous improvement actions to drive earnings higher over time.

Nick is going to start with a brief overview of Snap-on and then we'll dig deeper into the business. Representing the Company is Chairman and CEO Nick Pinchuk. In the audience are Aldo Pagliari, Senior VP of Finance and Chief Financial Officer, and Leslie Kratcoski, VP of Investor Relations.

<<Nicholas T. Pinchuk, Chairman of the Board and Chief Executive Officer>>

Okay. Like David said, I'm Nick Pinchuk. I'm from Snap-on. And I'm going to make a brief, a very brief, overview. Here's the beginning slide. Of course we always have to start out with caution and everybody read this. Good enough.

All right. Look, let me remind you, or tell you again, how we started, because it's worth understanding this or remembering it, to assess who we are and where we are going. Snap-on started in 1920, now its 95th year. And it started in 1920 and there were about sort of 0.5 million vehicles on the road and it was pretty new for the auto industry and really new for the repair industry. Nobody knew what status a mechanic would have or what tools they would use. And then comes an engineer from Milwaukee, Wisconsin, and he gets an idea.

He says he could make this all better. He takes five handles – we show them here, five handles of different configurations – an ellipse, a crank, a T. He puts them together with 10 sockets of different dimensions and fashions them so they snap on interchangeably. It was an innovation that revolutionized tool sets all over the world – all over the United States. And that tradition of innovation, that tradition of change and solving problems has echoed down through these decades for us. He did something else. He made it of high quality steel and he took up those tools, even if today if you pick up those 1920 tools, you say they are made sturdily. And today if you pick up a Snap-on tool you'll think it has the same quality.

But here's what he did that's most far reaching and most important. And we have it pictured here. He instructed his salesmen, when they went into the shops to lay the tools out on green felt, as if they were as precious as surgeons' knives, implying that if a mechanic used these tools he would declare to the world that he's doing something special, perhaps as special as a surgeon. And the idea of that specialness, the idea that the Snap-on branded tool displayed by the technician or used by the technician is the outward sign of their pride and dignity is at the core of our business.

If you don't believe that, I will offer this to you. We make something called tool storage boxes. These are big things. People put tools in them, right? They're made out of metal. We have what's called the 95th Anniversary Edition. They sell for $8,000, or $9,000 or $10,000 for an auto mechanic. We are etching this anniversary edition with the years 1920 and 2015 and we will sell a lot of them for $8,000 or $9,000.

Technicians buying these boxes, which are in effect shrines to the 95th anniversary, just because they want to be associated with Snap-on. Pride and dignity and specialness of work based on the strength of this brand. Now, over the years the Company has expanded, 11,000 people. You can see the tale of the tape up here. It's almost $9 billion in market cap, $3.3 billion in sales. And we pay dividends just north of a percent, 1.4%. The interesting thing about this dividend, I guess, is we started paying it in 1939 and we've paid one every quarter since. And we have never reduced it, probably one of the longest strings of uninterrupted, unreduced dividends around.

Now, one of the things we did – you can look at this chart here. Over the years we've thought of ourselves – everybody thinks about Snap-on, they think about the van business. It's a franchise business. We have 3,479 of them. They call on garages around the country on weekly routes. So there's a van at the BMW dealership this afternoon at 4:30, in the Lake Forest BMW; it will be there next week. And so we thought of ourselves as a business that was fundamentally – made great wrenches, sold through these vans to auto mechanics.

That was our business. And we prosecuted it well for years. But actually, more recently we realized that's only a narrow description of what we do. What we actually do is observe the work in any workplace; we figure out how to make it, from a practical point of view, better and easier. And we can do that whether it's a wrench or a piece of software. We've proven that. We don't need the vans, because 65% of our business is sold direct into distributor. And here's the most important thing: It doesn't have to be just an auto mechanic. It can be a professional of any kind, as long as they're working on a task they consider critical and therefore needs repeatability and reliability that justify Snap-on level premiums. So what we did was, we said – wait a minute.

Our only customers aren't the auto mechanics. So, we organized this way. Here's how we organized. And you can see it here. The red is 37% of our business. That is the van business, and they are selling directly to technicians, the guys who twirl the wrenches. But there's a customer base right next to them that really appreciates Snap-on, but we never concentrated on them. But they are still operating and doing critical tasks. They are the owners and managers of the shop. They buy at a difference cadence and they buy different things.

We have a whole group now focused on them called the repair system and information group, 28% of our business. And then, 30% of our business is for other industries, places that operate in criticality, like aviation, military, education, oil and gas, power generation. Rolling that Snap-on brand out of the garage and solving their problems, making work easier for a different group of customers, reaching more customers. But doing the same thing we always did for auto mechanics, that is, observing work and making it easier. And then we have a credit company, which you see up in the little yellow, I think it is.

And they serve principally the van business, financing big-ticket purchases like those anniversary boxes I talked about, and throughout the vans. And looking forward, we see ourselves having some opportunities. And we call these opportunities runway. The first are the runways for growth. And the runways for growth are almost along those customer bases. Enhance the van channel. By the way, the van channel grew in the first quarter 12.9% organically. Grew 11.8% organically the quarter before that. And it's grown greater than 6% 21 of the last 22 quarters. Expand with repair shop owners and managers. Sell to those repair shop owners and managers. That business grew 6.3% in the quarter. Extend to critical industries and build in emerging markets. We called it our commercial and industrial group. That business grew 9.8% in the quarter, grew 9.9% in the quarter before that, it grew 8.4% in the quarter before that, and 9.4% the quarter before that and 10.4% the quarter before that.

And then Snap-on for years, because we had this great van business we didn't pay attention too much to process improvement. All you had to do to deliver yourself from evil is to pound product down the van channel. That's all you had to do. And so, it got itself in trouble in the 90s and we tried – we lost who we are. And then we realized we had to do things like process improvement. So, we formulated what we call Snap-on Value Creation, our runways for improvement, around safety, quality, customer connection, innovation, and rapid continuous improvement. And that's helped us improve the business, get up every day and figure out how to make it better. And you can see it in the numbers.

If you're not familiar with the numbers, I'll recite them to you. In 2005 we had an OI margin of 6.5%. We said then we were going to mid-teens. I think people kind of chuckled. Next year was 7.6%. Next year was 10.6%. Next year was 12.6%. In the recession, we did get – we're recession resistant but not immune. It went down to 9.9%. Then it went 12.1%. Then it went to 13.5%. Then it went 13.9%. Then it finally went to mid double digits at 15.1%. Last year it was 16.3%. And in the quarter it was up 120 basis points. That was Snap-on Value Creation driving us down our runways for improvement. And we think, we're pretty confident, that we sit on one of the best – people ask us how much more we have to go. We believe we sit on one of the great industrial properties around. It has been under-wielded. And we continue to improve.

We believe we can grow the OI margin if we never got another dollar in incremental sales, because we think there's a lot more opportunity to improve. And we think we can grow coherently, not in any special way, but just doing what we always did for auto mechanics, but for different customers. We think this is a great property. We think it can be better. And if it isn't better, we aren't who we think we are. That's my pitch. Okay.

Q&A

<Q – David Leiker>: Great. Thank you, Nick. Any questions from the audience, put your hand up. I'll get you in. If you want to send me an email, session2@rwbaird.com, and I'll filter those in along the way. Let's start with the Snap-on Tools group. You've got a great franchise there, great business. You've done a great job of growing that business the years, decades that I've followed the Company. It's probably the strongest it's ever been. What are some of the things that are behind that growth? You're growing faster than what that market's growing. What are some of the reasons that that part of your business is growing at that pace? And what do you think that looks like going down the road?

<A – Nicholas T. Pinchuk>: Well, here's the thing. I think, David, there are I think two revelations we realized around – two or three revelations we realized about the Snap-on value – Snap-on van business. This is our traditional business and the one we know the best. It's written in our DNA. And part of it is that at one time we thought the way to grow, to reach more customers – because we know they're not reaching as many customers as we think they should – is to add vans. That didn't work. We called it feet on the street. We hemorrhaged all over it about 10 years ago.

Another thing we thought we could do is be more efficient and therefore consolidate our product line. We called it Project Simplify. It seemed to be the conventional wisdom of the way – we blew up all over it, because people paid us for the complexity and the breadth of the product line. So, we've resolved ourselves to the idea we've got to keep the product line broad so it solves a lot of solutions. We just have to manage that complexity.

So those two things are important. The third thing is – so we kind of realized that 3,479 vans now, we rise or fall with those van drivers. We have the best people. It's not so easy – we've understood who are the best people to put in the vans. We've figured out how to get them in there. We've reduced the turnover. And now we think we have a at least reasonable facsimile of the best people in these vans. And so our idea is how to amplify them, how to make them stronger. And there are two very, very clear structural restrictions on the van model. One is the space of the van. The vans are only so big. They're rolling retail space. Everybody talks about how much space – how much sales you have per square foot.

Well, we have a fixed number of square feet, and if we're going to fit with these 3,479 vans, so we have to figure out how to amplify the effectiveness of that space. We've done some of that, with things like we added the Rock 'N Roll Cab. This is a company-owned van. A van is about the size of a bread truck. I talked about these tool storage boxes. They're about this big and this high. You can only fit two of them on a van. If you ask the technician to buy something for $10,000 it's like people in this room buying a Lamborghini. And there are only two models of Lamborghini on the van and probably he didn't want – or he or she didn't want one of those. And so we were selling Lamborghinis without showing the model. Anybody in this room going to buy a Lamborghini without actually seeing the model? I think not.

And so, what we did was, we said, okay, we can remedy this by standing up Company-owned vans that will show up in that route in Lake Forest periodically. And so that's what happened. We have Company-owned vans, larger, filled top to bottom, front to rear, with tool storage units. And they showed up there and gave more retail space to tool storage for, let's say, two days a week this week in Lake Forest, that franchisee. And then he'd move on to another franchisee. We started out with 11 of them and now we have 66. Tool storage sales went up.

The other thing is, the other restriction is time. So we worked a lot on time, taking RCI – taking rapid continuous improvement to improve the selling time available to our franchisees and therefore allowing them to reach more customers. The amplification of the space gave us the opportunity to sell more to existing customers. The amplification and improvement of time allowed them to reach more customers. We know, for example, our vans only call on 800 to 850,000 technicians but there's 1.3 million technicians in America. They don't call on the other ones because they don't have time. We're giving them the time. And that's what's driving this improvement.

<Q – David Leiker>: Great. Thank you, Nick. Any questions from the audience? The auto mechanics are buying tools from the franchisees.

<A – Nicholas T. Pinchuk>: Yes. They're buying a screwdriver or a wrench four times the price that they could get it at Home Depot. Why do they do that? I would say that's a deep discount, if they could only buy 4 times.

<Q – David Leiker>: Why do they do that? What's so special about your product?

<A – Nicholas T. Pinchuk>: I think there are three reasons for that. One is our products are better. We're better at tool designing. You might think a hand tool is simple. I'm an engineer. I designed part of the – I worked on the Viking probe that landed on Mars in 2076, and I'm telling you that a hand tool, in the production of the hand tool between forging to near net shape under heat or cold and kneeling to take the stress out, machining sometimes to 1/30 of the human hair, heat treating to make it durable and flexible at the same time, and plating it, are very complex processes that all have a black art to them and are very special.

And then if you do it for [indiscernible] thousand SKUs, this is a fairly complex operation. And we do that better than anybody else. And so our hand tools, when you pick one up, you will see if you take a look – take a look at our ratchet. The cross section of our ratchet is smaller than anybody else's and stronger. Therefore, if you're trying to get inside the Audi, right, and it's kind of very, very tight, you get in more easily with our ratchet. That's one. Two, we offer a wider range of products than anybody else.

So when our vans call on these people they can solve a bunch of different things. For example, for reasons passing understanding, on the back-end spark plugs on an F-150 5.4 liter engine are almost impossible to get out. You break them half the time and you get an angry technician saying – it took me five hours to do this job when I'm only getting paid for an hour. They want to buy our long-range socket that will fix this problem. We have a variety. That's just for the Ford F-150. That's the – And then, three, the story about the green felt. Even today, the use of a Snap-on tool declares the professional. People buy our jackets for $80 apiece. I have a franchisee who sold 80 jackets for $80 among 200 customers, just because technicians want to make our products known. That's why they pay the premium.

<Q – David Leiker>: On the repair systems information business, there's a story that's floating around in the marketplace that this business is getting commoditized and that as we move to electrification or autonomous driving or things like that that this business is at some risk. What's your thought on that? And let's leave it at that. It was a terminal switch by the way.

<A – Nicholas T. Pinchuk>: Sure. Sure. Look, there are stories about everything. You can imagine everything around electronics. I think it's one of those things. Here's what we have. We simply have a better database than anybody. Very difficult to duplicate. What's happening in the business is there's a very favorable trend that's occurring, and that's this, that the percent of repair that is required of diagnostic, in effect a laptop for cars, is growing. Statistics like this – on used cars the car PARC – there are 300 million in the used car PARC – the average – 40% to 50% of the repairs require diagnostic. You can't repair the car unless you have one of these laptops to plug it in and figure out what the car's saying.

On new cars that's 80% of the repair event. Things like BMW you've got to reprogram the alternator when you change the battery. You used to be able to just haul out the battery and put in a new one. Well, you don't do that anymore. And so, what that means is that it used to be that shops would buy diagnostic [indiscernible] pass them around. But now technicians are starting to buy, and that's expanding the market dramatically. It won't go to commodity we think. And we're not seeing any evidence of that because our software sales, for example, were up tremendously in the fourth quarter and second quarter. And if you look at the numbers, RS&I group at 6.3%, defying gravity. So, it doesn't seem to be apparent in our numbers. And here's why I feel pretty confident, is because our position is rooted in the database.

Think of it this way. If you're in a Ford dealership, what are they working on? Technicians at a Ford dealership, they're only working on Fords. And they're only working on the new ones because the minute the car's off of warranty and you get the bill you think you've encountered a descendent of Jesse James or something like that. I mean, the bill is pretty high. And so, basically, that's the focus in the dealership. And we offer those. Ford gives us the data. We plug it in and we put it in our product and we plug it in for them. But if you're in an independent garage, they're having to work on 40 different badges. And how many different protocols?

And the same cars that had 100 engine codes to the cars today that have 5,000 engine codes, the same cars that didn't need any diagnostics that need 80%. They're working on all of those. And what happens with these things – we just brought out a new one for the maintenance tech, the young tech, it reads the engine codes and gives them some information. But at different levels – you go up from reading the codes to pushing the car through functional tests and seeing what happens to watching the car's heartbeat to actually being able to access what the OEM says to repair.

So the OE – if you go all the way up on this, you go through these procedures and then the OEM says – okay, you've seen this. This is what it says. Let's follow the repair steps down and you'll figure out what to do with the car. But then if you pay at the top end for us we will give you access – and we have the best data of all of that.

But we also have something else. If you follow that, we have a database based on hundreds of millions of records that says – if this car is a 2009 Honda that has 92,000 miles on it and you have a check-engine light, 92% of the time you change the fuel pump and it works. You don't have to go through anything else. So you see that's very powerful. So, our advantage is rooted in the data that's very difficult to duplicate. We're pretty confident.

<Q – David Leiker>: And then, what about electrification?

<A – Nicholas T. Pinchuk>: Yes. Any time a car – actually, one of the great tailwinds for our cars are changes in the vehicles. So you actually have to ask yourself this question – I love to ask this question. We make hand tools, all right? We make hand tools. And we make other things, of course, but a big portion of our product is hand tools. We guarantee them for life. The technician base is only growing at 1%. We guarantee the tools for life. How is it we have any business?

The answer is the cars keep changing – whether electrification is coming or not. For example, in the case of electrification there's a lot of voltage in the car. You don't want to be poking around in those without an insulated tool. By the way, before hybrids came out, or electric cars came out, we didn't insulate the tools. Now we have to insulate them. You don't have insulated wrenches? You'd better have some if you're working on those cars. Helps us sell. I will tell you this. In the time it went from 50 engine codes to 5,000 engine codes, we've only sold more hand tools, because the compartments have changed tremendously.

And that drives – we have guys getting on the vans say – I have 16 ratchets. I need another one because I can't repair the Audi without the new one. So, change is good for us, any change. I visited the Tesla dealership in Encino, California. I don't think it's a dealership; they call it something else. I walked in there, and Snap-on boxes all over the place. And our franchisee says he sells a lot to those guys. So I don't think we're too concerned.

<Q – David Leiker>: Any questions, audience? Commercial and industrial business, one of the – I think you still have it up there.

<A – Nicholas T. Pinchuk>: You want to go back?

<Q – David Leiker>: No. You're fine. Used to have a phrase that you used to talk about taking Snap-on out of the garage.

<A – Nicholas T. Pinchuk>: Yes.

<Q – David Leiker>: Could you talk about the critical industries piece of it, the nonautomotive tool part of your business, some perspective on what it is, where you're selling, how it's growing?

Right. The whole thing is like this. Simply remember I said that we used to think of ourselves as a company that sold wrenches through vans to auto mechanics. But we learned that we could sell to any professionals as long as they were operating in criticality, the penalty for failure was high. Well, that's true in a whole number of industries, like military, aviation, oil and gas, education, mining, power generation. And so what we're doing is we're learning how to sell in those places. And by learning I mean this. We have a huge advantage. If you present a Snap-on card this is one of the things that's hard to understand for a white-collar community. The Snap-on brand is respected everywhere and it's one of the most powerful brands in working America. But it's power decays exponentially as you rise off the first floor of any building. So it's less powerful in white-collar people, like me, you know? Because we're not quite as – because we don't twirl wrenches. But when you present a Snap-on card in a flight line, people give you gravitas. People give you respect. So, we have an opportunity with the Snap-on brand to get in there. People receive us well. What we don't have is we don't have the knowledge of the workplace that we have for auto repair, built up over a long time.

So, in auto repair we're able to constantly change the product line, because we understand the practical value of certain new tools. We understand it less in military and aviation, so we need to develop that. That's the pacing event. We're better in military, somewhat better in aviation, not so good in oil and gas. But that business grew at – commercial and industrial grew at 9.8% in the quarter, 9.9% in the quarter before that. And, you know, early days. Generally, except for the military where we tend to be pretty good, because it's the place we started first – you know, there's something critical about the 50 caliber bullets going over your head and you're repairing something. You think that is criticality, I would say. And so we worked on that. But, we were up in oil and gas in the quarter.

How many people up in oil and gas? The reason why we were up in oil and gas is we're just starting in a lot of these businesses. Yet, that's a fairly significant business and it appears to me – and we're confident it has tremendous runway. But, all we have to do is do what we did for mechanics. Growing coherently, we would say, we call it.

<Q – David Leiker>: And then, China.

<A – Nicholas T. Pinchuk>: Yes.

<Q – David Leiker>: I'll throw some numbers out first. Our estimate is about 100 million cars on the road in China. We have 300 million here in the U.S. With where sales are growing, 20 million plus in China.

<A – Nicholas T. Pinchuk>: Yeah.

<Q – David Leiker>: They're going to be at the level that the U.S. is in 10 years. What are you doing in China? What's your presence there? How big is your business?

<A – Nicholas T. Pinchuk>: Sure here's the thing. China is – I lived in Asia 11 years myself as you know. I now spend about six weeks a year in Asia, because I think it's very important to us. China as – you may not know this. China, I think, at one time, in 1840, represented 40% of the

world's GDP. So it's going to grow, so it's going to be pretty big even now. They will probably never go back to 40% but it's going to be a big market. But the fact is, China is the biggest market today for Mark Fields at Ford. They're selling more new cars than anybody else on the planet, maybe in the history of the planet. But in terms of repair, it hasn't really started. And so what we're doing is building the physical capability, one thing I know about my 11 years in Asia is you have to have physical capability to take advantage of the way the market's going to evolve. It's very difficult to predict how the market's going to evolve, because the economy's changing so fast. So what we're doing is we're building those physical capabilities. I'm pretty pleased with the progress in doing that.

For example, in 2003 in Asia, we were a late starter. We had 2 offices and 10 people. Now we have 1,500 people, 41 locations – 1,500 people, 5 factories, 41 locations, a design center and between 800 and 1,000 distributor partners and a growing product line. And we're continuing to build that. And we're making progress by – the strategy is basically to penetrate the most critical of applications – China Eastern Airlines, Thai Airlines in Asia, places like that, power generation stations. And we're having good penetration in that regard. Penetrating the best garages with our equipment, like aligners and balancers and so on, because they value the quality of that product.

And then saying – okay, we're going to have that position here. What's developing around the car market and in other things around repair, it still isn't viewed critical, because that capital equipment like cars are aging and people haven't started to do that, started having to view it as critical. So we're penetrating – if you call this the top-end position as a super-premium position with Snap-on brand, we provided a premium position with other brands, like Blue-Point.

We're penetrating that, and positioning ourselves for the day when people say – hey, this is critical. We're going to get the best here. And that's the thing we need to do. And we're trying a number of different distribution and product lines. Let's see how best to accomplish this as the wave goes. You can think of us in Asia as somebody that says – we see a wave coming. We're like a surfer that's paddling, trying to make sure we're there when it breaks.

<Q – David Leiker>: And then I just want to make sure people are clear. China – across your three businesses, which of those businesses are in place in China today?

<A – Nicholas T. Pinchuk>: Actually, they're all being run by – all of China is in C&I. And all of those businesses are there, except for the tools group. The tools group is not there because – so we have RS&I, the repair shop owners and managers, and the commercial and industrial business. And automotive is being handled direct in distributors, because the van business doesn't work.

Technicians do not own their own tools in China. And, like, the places where technicians own tools are limited to United States, Australia, New Zealand, and Great Britain, anyplace where the Brits were. And so that's where the tools group works. The automotive sector is handled by C&I outside of there.

<<David Leiker, Analyst, Robert W. Baird & Co.>>

Okay, great. And with that, we'll hold off additional questions. Nick, Leslie, and Aldo will be available in the Oak Room for a breakout. Please join me in thanking them.