20-Oct-2015

IDEX Corp. (IEX)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Third Quarter 2015 IDEX Corporation Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions]

I would now like to turn the conference over to your host, Michael Yates, VP and Chief Accounting Officer. Thank you, Mr. Yates. You may begin.

Michael J. Yates
Chief Accounting Officer & Vice President

Thank you, Tim. Good morning, everyone. This is Mike Yates, Vice President and Chief Accounting Officer for IDEX Corporation. Thank you for joining us for our discussion of the IDEX third quarter financial highlights. Last night, we issued a press release outlining our company's financial and operating performance for the three-month period ending September 30, 2015.

The press release, along with the presentation slides to be used during today's webcast, can be accessed on our company's website at www.idexcorp.com. Joining me today is Andy Silvernail, our Chairman and CEO; and Heath Mitts, our CFO.

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The format for our call today is as follows. We will begin with Andy providing an overview of the third quarter financial results, and then he will provide an update on what we are seeing in the world and discuss our capital deployment. He will then walk you through the operating performance within each of our segments. And finally, we will wrap up with an outlook for the fourth quarter and full-year 2015. Following our prepared remarks, we'll open the call for your questions.

If you should need to exit the call for any reason, you may access a complete replay beginning approximately two hours after the call concludes by dialing the toll-free number 877-660-6853 and entering conference ID 13604137, or you simply may log in to the company's homepage for the webcast replay.

As we begin, a brief reminder. This call may contain certain forward-looking statements that are subject to the Safe Harbor language in today's press release and in IDEX's filings with the Securities and Exchange Commission.

With that, I'll turn this call over to our Chairman and CEO, Andy Silvernail.

Andrew K. Silvernail

Chairman, President & Chief Executive Officer

Thanks, Mike, and good morning, everybody. I appreciate you joining us here for the third quarter 2015 call. As we all know, 2015 has been pretty challenging. We've talked about in previous calls the softness we've seen in the ag market, in oil and gas, and the strong U.S. dollar.

In the second quarter, we noted that we had seen some slippage in industrial distribution in the first half of the quarter, and we definitely saw that come back in the third quarter. And while these market conditions are out there and they remain, we have been very focused on delivering quality of earnings and cash flow, making sure that we're funding our best investments internally, and also really leveraging the benefits of our well-positioned, diversified portfolio.

I'm pleased overall with the execution that we had in the third quarter, and we saw some pretty decent numbers given the conditions. We delivered $0.89 of adjusted EPS, which is $0.01 ahead of last year. We had operating margins that were 21.5%, which is 70 basis points better than last year. In particular, we had impressive margins increase of 460 basis points in Fire & Safety/Diversified. And I'll take some time here a little bit later in the call to give some more color there.

We also had free cash flow of $105 million, which was 132% of net income, and we continue to focus on capital deployment. We closed the CiDRA acquisition. We divested a small product line business in Ismatec that had an $18.1 million gain, and we repurchased 911,000 shares for $66 million in the quarter.

As I talked about in the second quarter, we've also taken further steps to improve our cost structure through restructuring in all segments. In total, we now expect to spend about $8 million to $10 million in the year, with significant savings in 2016. For the full year, we now expect EPS to be $3.50 to $3.53, and even though we have the challenges that I've noted here in 2015, we're going to take them head on. We're going to continue to invest in our businesses. We're going to grow in select areas, and we're going to drive productivity across all segments.

Again, I'll give some color here more in a moment. But before I do that, let me talk about what we're seeing in regions around the world, some end markets, and also talk about capital deployment.

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In North America, as we all know, oil and gas and the ag markets have continued to be pretty difficult. As I mentioned before, industrial distribution did soften in the second quarter and continued into the third, and we do expect these conditions to continue here in the fourth quarter.

Europe remained stable, although we have seen pockets of growth, particularly in water and dispensing. And we have seen some uptick in our Energy business coming out of our European units. This has been offset by the continued weakness we're seeing in Eastern Europe from the political instability.

China, the story really remains the same. It's been in line with our expectations. It has been weak here for some time, but we don't expect it to deteriorate any further from here. Even though we are seeing some headwinds, there is a pretty nice momentum across geographies in a number of markets, and these include life sciences, municipal, and in dispensing. In total, we think that our current guidance captures the market conditions that I've talked about here.

With that, let me turn to capital deployment. This has been a real highlight for us in 2015. As we talked about here for quite some time, we have a four-pronged approach to capital deployment. Number one is really maximizing organic growth; two, consistent dividends; three, repurchasing shares when we believe it's below the intrinsic value of the company; and four, importantly, strategic M&A.

On the organic growth front, we've been investing aggressively. And these conditions, although they can be difficult, they really are fertile times for investing in organic growth. You see a lot of indiscriminate cutting by a lot of different competitors and what we're able to do is really focus on driving productivity, reinvesting into our – into growth areas and continuing to expand margins and cash flow. We're going to continue to reallocate people and resources towards our best opportunities where we can drive differentiation, we can drive growth, and we can gain high relative market share.

Some examples here in 2015 are the Viking Motor Speed pump, our fluidics systems for life sciences, our Gast 86/87 rocking piston, and our StrongArm in Rescue that we launched earlier in the year.

Turning to dividends and share repurchase, in the past three years, we've increased our dividend by two-thirds, and in the recent quarter here, we're declaring our $0.32 dividend. And for the year, we've repurchased 2.4 million shares for $179 million, and you can expect to see about a 3% share reduction here in 2015.

In terms of M&A, we've deployed about $200 million this year in three acquisitions – Novotema, Alfa Valvole, and CiDRA Precision Services – and those lay across three different businesses within IDEX. And the M&A funnel continues to be strong, and we've got opportunities across our segments. Going forward, you should expect to see us continuing to leverage our balance sheet and strong free cash flows in this important strategic priority.

All right. Let me now turn to the third quarter results. I'm on slide 4. Orders were $485 million. They were down 4% in total, down 2% organically. For the quarter, revenues were $504 million, down 6%, down 4% organically. We've talked about the major contributors in terms of oil and gas, the ag markets, and slowing North American industrial. However, op margins and free cash flow were both very strong in the quarter. Operating margins, as I noted, were up 70 basis points to 21.5%. Free cash flow was $105 million, converting to 132% of net income.

And as I said, EPS for the quarter was $0.89, up $0.01 from last year. And again, overall, I'm pleased with the execution and pleased with the discipline that our teams are bringing to this challenging marketplace.

With that, let me turn to the segment discussions. I'm on slide 5 and I'll start with Fluid & Metering. FMT organic orders decreased 3% in the quarter. Organic sales were down 4% primarily due to the challenges I've already

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discussed. Operating margins were down 120 basis points in the quarter due to lower volume and non-cash acquisition charges.

Let me note, however, that if you remove the impact of the acquisition inventory charges for Alfa, FMT margins were actually flat year-over-year, so that's nice performance in the face of some volume declines.

In Water Services, we've had a strong global municipal market in particular in the U.S. We saw municipal business up about mid-single-digits to the quarter. The UK has also had improvements in the marketplace and we've won share with new products. And across the platform, we've had margin expansion and I expect to see that performance continue really through the balance of this year and into 2016.

In Industrial, I've already talked about what we're seeing in the overall market and this is true in our pump business, and we do expect those conditions to continue through the year. However, if you look at North America and Europe, particularly in the chemical businesses, we're seeing low-single-digit growth and we're seeing nice momentum as we enter 2016.

In Energy, we've actually had a surprisingly good story here. Overall top line remains stable in this environment. We've kept price, and we've seen some business uptick in the European and Middle East, some downstream projects that have rebounded here recently. This has been offset, however, by the issues that we're seeing in North American oil and gas.

Outside of large projects, if you look at North America, we're seeing strength in aviation due to lower fuel prices, but our mobile business has been a little bit slack here, as we expect the truck builds to slow down in 2015 and in 2016.

On the Ag front, you know the story very well. We've had weakness here throughout the year, as we expected. We do expect that to continue in 2016. But again, this is a business that, long term, has been favorable for us, and we believe will continue to be over time.

All right. Let me turn to slide 6. I'm on – we're talking about Health & Science. In the quarter, organic – order growth was up 2%. Organic sales were down 3%. Op margins decreased 40 basis points, really driven by business mix. In terms of the different platforms, Scientific Fluidics really continues to be a bright spot for us. It's been – we've seen strength in analytical instrumentation, in bio, and in the IVD markets, and we expect this demand to continue in 2015 and into 2016.

In Sealing, that's been a little bit of a mixed bag. We've seen some nice share wins in semiconductor, although that has been offset by the weakness in upstream oil and gas. And we expect these conditions really to continue throughout the balance of this year.

Optics & Photonics has been stable in the quarter. We saw the industrial and the laser optics business weaker, but underlying life science demand has been very solid. And again, profitability continues to expand in this platform.

HST industrial looks a lot like what we talked about in FMT, with distribution softening, but the team has done an excellent job winning business in adjacent markets and continuing to improve productivity. In Material Process, it was actually a strong quarter for MPT. We saw strong orders momentum going into the fourth quarter really across a number of markets, particularly in Asia.

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We expect to see the benefits of this in the early part of 2016. As you know, this is a lumpier business for IDEX. We are seeing capital spending spotty over time, but this is a good news story right now and into the early part of 2016.

All right. Let me move on to the final segment; I'm on Diversified on slide 7. Organic orders were down 8%, and they decreased – and organic sales are down 5%. The decline is principally driven by tough comps compared to the fire trailers of last year and softness with BAND-IT, really with the depressed energy prices.

As I mentioned earlier, we had operating margins that increased 460 basis points, and this is obviously a very impressive performance for the team. But I will caution you not to set that as a new benchmark. In the last two quarters, we've had outstanding business mix, specifically within the Dispensing and the Fire businesses, and we expect in the future to see more normalized profitability.

Dispensing has been a good news story for us across the globe. We've seen strength in North America, in Western Europe, and in Asia. The wins that we're seeing have been driven by the improvement in overall construction markets, but very importantly, the strength of our X-Smart product, which is going to grow another 25% this year over last year.

In Fire Suppression, the core North American and UK businesses have been in decent shape. And although we don't expect any particularly large projects this year, we are continuing to see nice wins in those domestic businesses and excellent profitability, driven by productivity across the platform.

In Rescue, we did see some delays in projects internationally, but the North American business has continued to be strong. eDRAULIC 2.0 has taken share consistently. And we launched our StrongArm tool, which is a utility tool for fire and for law enforcement markets. And we think this is going to have nice momentum going into 2016.

Finally, looking at BAND-IT, as we talked about, the conditions have been difficult. The industrial distribution and the oil and gas businesses have been challenging to BAND-IT, but the transportation segment has continued to grow. BAND-IT has been a bellwether for us, continues to perform, and we have high expectations for the business going forward.

All right. Let me conclude now with the fourth quarter and the full-year 2015 guidance. I'm on slide 8. For the fourth quarter, we now expect EPS to be $0.88 to $0.91 and operating margins of 20.5%, Q4 tax rate should be around 27% to 27.5%, and we expect about a 3% top line headwind from FX. As I mentioned earlier, we now expect full-year EPS to be $3.50 to $3.53, and we expect revenue growth to decline about 2% to 3%, and full-year operating margins to be about 21%.

All right, just a couple other modeling items for you for the full year. We now expect FX to impact us by about $90 million for the year, compared to $95 million in prior guidance. And that's about $0.20 of EPS impact for the full year compared to 2014. CapEx should be about $45 million, free cash flow about 120% of net income. And again, share repurchases should decrease the share count by about 3% for the year.

Finally, as always, we need to exclude the impact of acquisitions, both positive and negative, and also take out the impact of restructuring charges and the gain of sale from the Ismatec product line.

With that, Tim, let me turn it over to you for questions from our audience.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line Mike Halloran at Robert W. Baird.

Mike P. Halloran
Robert W. Baird & Co., Inc. (Broker)

Q

Can you hear me?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Yes. Hi, Mike.

Mike P. Halloran
Robert W. Baird & Co., Inc. (Broker)

Q

All right. Making sure. So, a couple of ones here. First on the HST side, I was a little surprised that the organic revenue declined in the quarter, but obviously, the orders were pretty solid. So maybe talk a little bit about if there was any blips in the quarter specifically that would have may be changed what the run rate is in that business and how you're thinking about the progression as we move into the fourth quarter in 2016.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Yes. So, Mike, on HST in particular, things that were touching the scientific world, life sciences, in particular, we saw nice strength, anything touching food. We had strength in – it really – any weakness that we saw in the quarter was due to the industrial portion of it, principally around Gast. As you know, that [indiscernible] (16:19) a lot more like FMT and that's – any slowdowns that we had there that the core scientific and health pieces of the business performed very well.

Mike P. Halloran
Robert W. Baird & Co., Inc. (Broker)

Q

And as you think about that on a run rate going forward, is this an area where you're expecting organic growth in the fourth quarter or is that something that might normalize out as you hit next year and some of those MPT projects that you mentioned start rolling through?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

So, if you think about 2016, I would expect that to be the case. I think you've got nice strength in life sciences and we will see in the early part of the year, the benefit of the projects from – for MPT shifting. In the fourth quarter, net-net, you end up being flat year-over-year.

Mike P. Halloran
Robert W. Baird & Co., Inc. (Broker)

Q

And then more broadly as you work into 2016 here...

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Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

[indiscernible] (17:09).

Mike P. Halloran
Robert W. Baird & Co., Inc. (Broker)
Q

Yeah. No, I understand completely. You're still going to have the FX headwinds. As you work into 2016, maybe you can just talk about some of the thoughts you guys are having internally going into next year. Where are the buckets where you think that growth is going to be achievable as you hit next year and where do you think the headwinds are going to persist as we go into next year? Essentially just an early read on what you're seeing in the environment today and what that tells you about next year?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

I think the biggest headwinds we're going to see are going to be in the first and second quarter, which I think they'll be meaningful, right? So the falloff in spending that I think everyone has experienced relative to capital projects in oil and gas, I think they really – in terms of from a comp perspective, they're going to be tougher in the first and early in the second quarter and get a little bit easy as you get into the third and the fourth quarter next year. I think that'll absolutely be the case.

Ag is a little bit of a wild card, to be honest with you, Mike. It's a little bit tough to find the bottom there. I think everyone has worked through that. You've seen what's happened with the big capital producers. But net-net, I don't see that as a big negative going into next year.

I think the biggest question mark is going to be what happens with industrial, kind of the North American industrial business, and what happens with China. Those are the two things that I think are the biggest question marks going into really the fourth quarter. I think the fourth quarter we got pretty dialed in. But I think, as you go into next year, those are the biggest things.

In terms of upside, I think municipal is going to continue to be good. All signs continue to point to that. I think that the scientific piece of our business in life sciences, whether it's analytical instrumentation or bio, IVD, those are good news stories really across the board.

And you've had a lot of headwind from FX that we started to lap here as we get into the back half of this year, first part of – back half of the fourth quarter, first part of next year, and we'll see how that plays itself out.

But, Mike, I've said pretty consistently that I expect 2016 to be a slugfest. I don't think it's going to – the market conditions are going to be meaningfully different from what we've seen, and it's going to be about being very smart with internal capital deployment, meaning where we invest in our businesses, driving productivity, and very smart external capital deployment.

Mike P. Halloran
Robert W. Baird & Co., Inc. (Broker)
Q

Makes a lot of sense. One last one for me. Obviously great FSD margins. Recognizing that those aren't sustainable, you highlighted the normalization you expect. How do you define normalization? Is that toward something that 26% kind of range for that segment on the margin line, or should we be thinking about a little bit different now?

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Heath A. Mitts
Chief Financial Officer & Senior Vice President
A

Mike, I think modeling it, given the relative size of the segment within the portfolio, $1 million here and there can swing the percentages around quite a bit. So I think modeling it probably between that 26% and 28% range is fair.

Mike P. Halloran
Robert W. Baird & Co., Inc. (Broker)
Q

All right. Thanks, guys. Appreciate it.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Thanks, Mike.

Operator: Our next question comes from the line of Steven Winoker at Bernstein. Please proceed with your question.

Peter Richard Lennox-King
Sanford C. Bernstein & Co. LLC
Q

Hi, everybody. This is Peter Lennox-King on for Steve. I was wondering if you could maybe talk me through a little bit more detail on the restructuring front. Is the allocation between the segments for the remaining $3 million to $5 million or so that's in the guidance, is that allocation going to be similar to what you had in Q3? And then could you talk through a little bit of the payback timing, the magnitude and where – how big the benefits will be for each segment, as much as you can?

Heath A. Mitts
Chief Financial Officer & Senior Vice President
A

I think the spread, as you noticed in our adjustments that we've made by segment, was a little heavier towards FMT and HST in the third quarter with the Fire & Safety, the Diversified business only receiving about $300,000 of that charge. It will probably be a little bit more ratable in the fourth quarter, but still heavier towards FMT and HST.

In terms of the aggregate payback for that so we're going to end up taking a charge of somewhere between $8 million and $10 million in the second half of the year. You can assume that that payback has somewhere less than a one year payback. So, obviously, the benefit from that which we will quantify as we go onto next year's guidance here on our January call will be somewhere north of the charge.

Peter Richard Lennox-King
Sanford C. Bernstein & Co. LLC
Q

Yeah. Okay. Thanks. And then maybe shifting gears a little bit back to capital deployment. Can you talk a little bit about the M&A pipeline? How are you thinking about getting more aggressive, less aggressive in the current environment with all the volatility? And then, again, as much as you can, which segments you're sort of targeting or which businesses you're looking to really move on?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

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So, Peter, in terms of the segments, we actually are looking at things across the three segments. And there are some things that we've been cultivating for quite some time and some things that have developed in the recent past that make our pipeline pretty attractive. We feel good about where our pipeline is generally both in the near-term and in the longer-term. And so, we feel pretty good here about our ability to execute on M&A maybe in the balance of this year, maybe not, we'll see. As you know, these things move around quite a bit, but certainly as we go into 2016, we have an expectation of doing so.

And as you know, we made an important organizational change here in earlier this year and a big piece of it was really freeing the organization to be more aggressive around M&A. We've got a great balance sheet as you know, our cash flows are terrific, and we think that we have the organizational structure to do it. The environment is an interesting one, right, because this is an environment, as you pointed out, Peter, that's very volatile.

At the same time, as you say, sometimes you've got to take the cookies when they're passed, and there are some pretty nice properties that are out there. You may not buy them at the perfect time, but at the same time, we understand what we're looking for, and we're looking for businesses that are structurally fit over the very, very long-term and are going to deliver high returns for shareholders.

Peter Richard Lennox-King
Sanford C. Bernstein & Co. LLC

Q

Great. Thank you. And just one final follow up there. The aggregate spend over time that you're looking at, is that still thinking about the same sort of size range there and the same individual – size of individual deals as well?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Yeah. Yeah, I mean, our sweet spot is that kind of $50 million to $200 million, $250 million. That really is our sweet spot. As I've said in the past, there are a few things that are larger, that are north of $1 billion that we look at consistently. Those are few and far between, but there are some that are out there. But our sweet spot and where we really drive value for shareholders is in that $50 million to $250 million range.

Peter Richard Lennox-King
Sanford C. Bernstein & Co. LLC

Q

Great. Thank you very much.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Thanks, Peter.

Operator: Our next question comes from the line of Matt McConnell at RBC Capital Markets. Please proceed with your question.

Matthew McConnell
RBC Capital Markets LLC

Q

Thank you. Good morning, guys.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

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Hi, Matt.

Matthew McConnell
RBC Capital Markets LLC

Q

So, guidance for the fourth quarter, it seems like organic revenue declines are moderating. Is that what you intended to incorporate in the outlook? And how much of that is coming from an easier comp in Fire & Safety versus any kind of stabilization or sequential improvement in the other two segments?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Matt, we're not expecting sequential improvement. It really comes down to comps when you look at the fourth quarter. I think this environment right now is squishy enough that any belief that we're going to see a material change in the external environment in the fourth quarter, I think that would be misplaced.

Matthew McConnell
RBC Capital Markets LLC

Q

Okay, great. Thanks. And just a quick follow up, Andy, you made a comment that China you don't expect to deteriorate from here. Is that based on specific customer conversations or just what gives you the confidence to make that kind of declaration?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

We've had a pretty tight [ph] beat (25:59) on China here. If you remember, if you go back even, [ph] I don't know (26:01), a year or 18 months ago...

Heath A. Mitts
Chief Financial Officer & Senior Vice President

A

[indiscernible] (26:03).

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Yeah. We started talking about the fact that we thought the China was meaningfully weaker than the, call it, the headline commentary. And for us, it really is kind of looking at the underlying business and where we're seeing demand. Our Richter business in particular continues to be strong in China and that's been a real winner for us. And we do expect our Rescue business to pick up here as we look at the balance of this year and into 2016. So it's much more specific to the businesses that we're in versus a call on the China economy.

Matthew McConnell
RBC Capital Markets LLC

Q

Yeah. Okay, great. Thanks. And last one just a follow up on the capital allocation question because you've been real aggressive with the buybacks but clearly pretty happy about the M&A pipeline and opportunity. Is there a self-imposed leverage threshold where you might slowdown the buybacks or what kind of deal do you have capacity for right now, given that you've spent quite a bit of your free cash flow this year?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

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We're still only sitting at just north of a turn of net debt, right? So we've got a great balance sheet, so I'm not awfully concerned about that and obviously, the free cash flow is very, very strong. When it's all said and done, when you put the two side by side, our preference is strategic M&A. It certainly creates more value, unless you have a major dislocation in the stock price. And so, obviously, as we move down that path and as deals come through, we would naturally slow down M&A.

But it's very – excuse me, slow down repurchases – but let me note really clearly, our repurchase program is 100% driven on what we believe the intrinsic value is of the company. And you'll see our acceleration or deceleration based on a very, very well-thought-out analysis of what we think that is.

So, as an example, when we saw the stock drop down into the $60s earlier this year, we were a lot more aggressive than we are today. And when the stock was up closer to $80, we were then buying back closer to 0.5% to 1%. So, strategic M&A is number one. We got plenty of capacity to do that, and share buybacks are driven 100% about value.

Matthew McConnell
RBC Capital Markets LLC

Q

Great. Thanks very much.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Thank you.

Operator: Our next question comes from the line of Kevin Maczka at BB&T Capital Markets. Kevin, please proceed with your question.

Kevin Richard Maczka
BB&T Capital Markets

Q

Thanks. Good morning.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Hey, Kevin.

Kevin Richard Maczka
BB&T Capital Markets

Q

So, some kind of encouraging comments here within FMT on the muni water side and really on the energy side, too. I'm wondering if you can say a little bit more about that muni water spend, what you're seeing, how you think that plays out going into next year, if there's any kind of submarkets that are driving that? And then, on the European energy side, what's driving the pickup there?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Sure. On the muni side, a couple of things. Number one, a general uptick in overall spending, driven by tax receipts. And we've talked about, for a long time, that there's – anytime you start to see major movements in tax

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receipts, there's kind of a 12-month to 24-month lag or a lead-time, depending upon which side of the cycle you're on.

And so, those tax receipts are starting to lift all boats, so to speak. There's just more money in the CapEx and in the OpEx budgets in the western parts of the world than there were 12 months, 24 months ago, so that's one thing. The second thing is, really our strategy, in particular in Water Services, has paid off. So we have continued to win share in our target markets and target applications. And that's what's driving the success above and beyond market.

So as I look at 2016, we know what's in the quote pipeline, we know what we've won, and we believe – we feel pretty confident that the market is going to be better than it was this year, and certainly better that it's been in the last couple of years. So, in combination, it's not like it's roaring at high-single-digit or double-digit, but a solid mid-single-digit in the U.S. in municipal water. That's a good piece of news generally.

In terms of the energy side, I wouldn't get too excited about that, and what I mean by that is, our holding our top line, you've got to remember a couple of things. First, we really don't play very much in the downhole side of the world, right? So as we said the past, that's been 2%, 3% of our total portfolio for IDEX. Obviously, that 2% or 3% has been battered this year with the reductions that you're seeing. But we mostly play in that midstream market that has held up better, so that's kind of one thing to remember.

Second thing is, we've had some really nice wins in aviation that have been really share wins for us, and we've seen that across the globe. The third is, there are a number of projects that we've been on top of – in the past, we've talked about the fact that they got pushed out. And we didn't win, and we're starting to see those flow through in Europe and the Middle East. I would not say that is commentary about the health of the overall market, but more so our business unit performance.

Kevin Richard Maczka
BB&T Capital Markets

Q

Got it. And Andy, in terms of price, it sounds like you've held price on the energy side. Are there some other areas, whether it's in FMT or beyond, where you've been able to get some price, or maybe you've had some pressure?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Actually, no pressure. I mean, we get the letters that everybody else gets from our customers. But at the end of the day, we'll command what, Heath, north of a point this year? Right around a point?

Heath A. Mitts
Chief Financial Officer & Senior Vice President

A

Right around a point.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Yeah. We'll get a point of price here before the inflationary impacts, in terms of – to net it out. But we'll get a point of price this year, with no significant places of price pressure.

Kevin Richard Maczka
BB&T Capital Markets

Q

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Got it. And just finally from me on mix. So that – from time to time, it can be such a big margin mover.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Yeah.

Kevin Richard Maczka
BB&T Capital Markets
Q

This quarter, of course, we saw it in FSD, and it doesn't sound like you're expecting that to sustain. I'm just wondering, kind of across the portfolio, is there anything, in terms of the visibility that you do have, that we ought to be aware of in terms of mix, either positive or negative, as we look at Q4 or maybe even into next year?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Well, a few things. Generally, as a portfolio, the only place we see mix impact us significantly is in FSD. In the last two quarters, that has been – obviously, it's been a good news story for us, and we're cautioning you guys not to build margin assumptions north of that 28% range. The 26% to 28% that Heath gave earlier, I think that's a healthy place to be.

In terms of FMT or HST, I don't expect there to be major mix shifts within those businesses. Here or there, but not enough to long-term change the trajectory of the business. Within FSD in particular, right, the margins there – if you go back in time, the margins there have been moving up substantially. We've really improved the profit profile of Fire and of Dispensing and that has changed the overall profit profile of FSD. We're at the point now where I don't expect the kind of gains we've had to replicate themselves and I think we're in a pretty good spot there in particular.

Kevin Richard Maczka
BB&T Capital Markets
Q

Okay. Thank you.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Thanks, Kevin.

Operator: Our next question comes from the line of Allison Poliniak at Wells Fargo. Please proceed with your question.

Allison A. Poliniak-Cusic
Wells Fargo Securities LLC
Q

Hi, guys. Good morning.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Hey, Allison.

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Allison A. Poliniak-Cusic
Wells Fargo Securities LLC

Q

Just going back to MPT, obviously more positive on there. When you talk about the order growth, was it essentially projects that we should have seen in 2015, got pushed to 2016 and I guess what's the risk if that's the case to 2016 orders right now?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

So, I mean, as you know, Allison, this is – if we have any place that's lumpy, this is it. And you can see some pretty significant swings that can move the organic orders and organic sales for HST in a quarter in a more meaningful way than some of the other businesses. So, what's you're seeing right now is we have some nice wins here in the quarter that helps certainly on the organic order front and they are really going to shift in the second part of – excuse me, in the first part of 2016.

In terms of what that means, looking forward, at this point, we don't have visibility kind of for the fourth quarter or third quarter in orders that might look like this, maybe we got a lot of stuff in the hopper, but there's nothing that makes me particularly excited or particularly concerned relative to that and how it may play out in the fourth quarter and therefore later in 2016.

Allison A. Poliniak-Cusic
Wells Fargo Securities LLC

Q

Great. That's helpful. And then sorry to go back to the FSD margins. If I'm looking at that nice expansion this quarter, I guess, based on your commentary, can I assume half of that was driven by mix, with the balance being the productivity efforts, or is my math off?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Yes, it's probably a little bit more than that. In general, the mix impact, I would say, looks probably more like two-thirds to three quarters, and I'm kind of thumbnailing it here. But the productivity, we definitely saw nice productivity, but we did have a meaningful mix shift in those two businesses.

Allison A. Poliniak-Cusic
Wells Fargo Securities LLC

Q

Great. Thank you.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Thanks, Allison.

Operator: Our next question comes from the line of Joe Radigan at KeyBanc. Please proceed with your question.

Joe K. Radigan
KeyBanc Capital Markets, Inc.

Q

Thanks. Good morning, guys.

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Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Good morning.

Joe K. Radigan
KeyBanc Capital Markets, Inc.
Q

The sequential margin decline in FMT and HST, was that largely a function of the inventory step-up? And then more generally, how do you think about margin sustainability across IDEX in what looks like it's going to be a relatively protracted slow growth environment going forward here?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

So specific to FMT, the step-up, that was a meaningful impact from a quarter to quarter. And as I said, if you actually normalized for the inventory step-up charge, on a year-over-year basis, FMT margins would have been flat. So you can kind of back into what that tells you there. So really on volume being down modestly, pretty nice performance in the business in terms of profitability.

From an HST perspective, nothing really meaningful in there. There's nothing that I would say signals one way or the other any change in margin profile. If you look at the longer term, we've said pretty consistently that in a low growth environment, call it, 2%, 3%, somewhere in there, we can get 50 basis points to 80 basis points, maybe even up to 100 basis points, depending upon – on what happens in profit improvement.

But if you look at that – if you're in the 2% range, you're probably looking at 50 basis points. If you're in the 3% range, you're probably looking at 80 basis points of expansion just because our contribution margins are in the low-60%s. And so that plays itself through very [ph] healthily (37:27), and we can continue to invest in the business.

Obviously, if we get a benefit and see things pick up faster, you're going to reinvest even more, but you're still going to see really, really nice margin expansion. So, even if we continue to be in this environment, I feel good that if we see just modest improvements in top line, we're going to continue to expand margins in the core portfolio.

Joe K. Radigan
KeyBanc Capital Markets, Inc.
Q

Okay. And then within the Optics & Photonics business, that, I think, commentary for the last few quarters has been stable, maybe it weakened a little bit this quarter. But what needs to happen for that business to start growing again? I mean is it really the industrial end market that's holding it back or what...

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

It is.

Joe K. Radigan
KeyBanc Capital Markets, Inc.
Q

...any commentary there?

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Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

It is. Right? So, if you look at – if you separate out the life science piece, which is performing – continues to perform well in the core life science markets, you're now talking about the industrial and the semiconductor market. And in both of those – neither one of those have been particularly strong.

So – and also, to be fair to our team running the business there, we have been really tight on making sure that we're going after attractive business. And so, part of it has been self-imposed to make sure that we're going after the right business there. But if you get an improvement in the industrial and the electronics world, you'll see some nice pick up.

Joe K. Radigan
KeyBanc Capital Markets, Inc.
Q

Okay. And then maybe lastly, Andy, as you look at acquisitions, how do you get comfortable with the forward projections in this sort of demand environment? Has that been an impediment in getting deals to the finish line, or how do you think about that?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

So, the way I kind of think of it is what's a business going to look like through a cycle? And you'll never buy perfectly, right? But what you're trying to avoid is buying something that's going to have kind of a really aggressive secular downturn, number one, or something where you're really buying on the come. And those are the two situations that you get yourself into trouble in terms of kind of building in any type of – from a growth perspective.

Generally, we're looking at businesses. I'll use Alfa as an example, right? So, Alfa is a business with a 30-plus-year installed base. You can kind of look at it through a cycle. And even if you don't buy it perfectly, buy it from a perfect timing in a cycle, by the time you get on the back half of any kind of slowdown, you're still thrilled you own the business. So, you have high cash-on-cash returns, high cash flow businesses, you know what a cycle generally is going to look like. You may not pick it perfectly, but if you're buying, what I'll call, an IDEX-like business, you don't have to time the market perfectly or get the price exactly right to have it be a huge winner for you over time.

And so, we're more looking for the quality of the business to recycle, high cash-on-cash returns in a business, strong repeat business installed base, a big moat defensibility and high relative market share. And when you get that right, timing becomes less of an issue than one might think.

Joe K. Radigan
KeyBanc Capital Markets, Inc.
Q

Great. Thank you.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Thank you.

Operator: Our next question comes from the line of Bhupender Bohra at Jefferies. Please proceed with your question.

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Bhupender Singh Bohra
Jefferies LLC

Q

Hey. Good morning, guys.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Good morning.

Bhupender Singh Bohra
Jefferies LLC

Q

So, you guys actually spoke about industrial distribution business kind of weakness, what we have seen here. Could you talk about like destocking? Is that one of the issues within that, the end market? And how long do you think, if you have any visibility on that, like the destocking or the slowdown within the distribution channel will last?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

So, as we said in the past, unlike I think some of our peers, we don't have kind of, what I'd call, the traditional industrial distribution channels. We're not dealing with the big catalog houses per se. We're dealing much more with value-added distributors. So we don't have huge stocking levels in the channel anyway. You have some obviously that's driving lead-times and on-time delivery, but you don't have months and months and months of stocking in the channel.

So while I'm sure that it's part of it, and I'm sure part of what we're experiencing right now and others are experiencing has to do with them being tighter. I do think that you're seeing overall demand slacking. And then inventory in the end market, I think, is tightening substantially. So if you want to put the destocking moniker on something, I would say it's more at the end user who's gotten cautious. You're seeing the ripple effects just like we are, right?

We're tightening down on working capital as things are slowing, and you're seeing that play out across the landscape. And I do expect that to be tight, and just like we've seen in the past, when that starts to loosen again, you'll see a nice pop, and that will be a surprising upside in the quarter at some point. But right now, I really think that what we're all seeing is mostly a slowing of aggregate demand with a little bit of impact of the concept of destocking.

Bhupender Singh Bohra
Jefferies LLC

Q

Okay. Thanks a lot. And the other question, we have about $8 million to $10 million restructuring this year. Let's say, I don't know how much visibility we have for 2016, but can we actually, if need be, if the environment actually slows down further as we are looking at North America, which is half of your business, seeing some slowdown here this morning like there were many other reports which came out talking about weakness in the North America market. Like what kind of cost cuts we can further kind of depend on or can tap into some of the buckets if you can talk about?

Heath A. Mitts
Chief Financial Officer & Senior Vice President

A

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Bhupender, rest assured that if we continue to see the market downturn, we'll continue to drive this type of savings that we need. I think you've seen that over time with IDEX, and know that it's built in to the way that we think about reacting to positions, in terms of where we sit cost structure-wise. But also know that we do have areas that we need to continue to invest in, and we're not starving those parts of the business. It's important, for the types of businesses that we have where we get [ph] spec'd (44:24) on to platforms and instruments and so forth, that we continue to invest and not miss those cycles.

So the balancing act, as always, is to continue to make sure we free up the dollars to invest in the growth areas and the areas that are more strategic and require incremental investments, and then go after the areas that tend to be more volume-based. And so, yes, we do have pockets that we can go after if need be.

Bhupender Singh Bohra
Jefferies LLC

Q

Okay.

Heath A. Mitts
Chief Financial Officer & Senior Vice President

A

And we feel pretty good about the actions we have relative to our assumption set for 2016, and we'll quantify some of that in the January call.

Bhupender Singh Bohra
Jefferies LLC

Q

Okay. That's all. Thank you very much.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Thank you.

Operator: Our next question comes from the line of Joe Giordano at Cowen. Please proceed with your question.

Joseph C. Giordano
Cowen & Co. LLC

Q

Hi, guys. Good morning.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Good morning, Joe.

Joseph C. Giordano
Cowen & Co. LLC

Q

Just to follow on with the destocking question. I fully understand – I appreciate what you said about where you guys fall within that. But do you get the sense that your customers are more – are they destocking in an anticipatory fashion, like more so than actual demand might require at this time? Are they anticipating even further declines from here? Do you get that feel?

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Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

It's hard to gauge that. And obviously, we're pretty close to our customers. I think cautiousness is out there across the board. And so there probably is some of that. I mean, probably the best way to think of it is, look at ourselves, right, and kind of how we're behaving. And as we see this environment, we are tightening down on our overall inventory and being more cautious about what we bring in and what goes out. So, I think there is a level of cautiousness out there that can start to feed on itself a little bit.

But to be candid, Joe, I don't think I have a tight enough [ph] bead (46:15) to be able to call that exactly, what's the mix of actual demand versus cautiousness. I mean, typically, as we always see, people react too slowly at first and too quickly at the end.

Joseph C. Giordano
Cowen & Co. LLC
Q

Yeah.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

And so there's always a mix of that. But I think, right now, I think we got a pretty good bead on – certainly on what the fourth quarter looks like, and I think that next year is going to be a pretty slow growth environment.

Joseph C. Giordano
Cowen & Co. LLC
Q

Great. Appreciate it. Thanks, guys.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Thanks, Joe.

Operator: Our next question comes from the line of Matt Summerville at Alembic Global Advisors. Please proceed with your question.

Matt Summerville
Alembic Global Advisors
Q

Thanks. Good morning, guys.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Hi, Matt.

Matt Summerville
Alembic Global Advisors
Q

A couple of questions. First, just in terms of the global chemical market, it's not an inconsequential end market for you guys. It's about 20% or so of FMT. Can you give a little more specificity, regionally what you're seeing there, and I guess, again, high level, I get it, how you're thinking about that for 2016? And then I also have a follow-up.

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Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

So, Matt, what we're seeing in North America and in Europe is, I'm going to call it a low-single-digit growth environment. And so it's holding up pretty well. China has been a little bit better, but I think that's driven more by our own actions, particularly with the Richter brand, than it is necessarily what we're seeing in the end markets.

And India has been pretty good for us, too. So, really across the board in the markets that we play in, chemical has been, yeah, I'm going to call it a good news story in a slow growth world. So, it's not like it's racing ahead, but it's been solid.

And I expect that to continue into 2016. If you look at the business in terms of the pipeline of what we're looking at and our expectations coming out of our units, I think expecting a low-single-digit environment, 2% to 3%, is probably a good place to put your bets.

Matt Summerville
Alembic Global Advisors
Q

And then, just with respect to China, since you specifically brought it up, talking about chemical. When you came in to 2015, what did you expect your organic growth rate to be in China, and where do you actually think it ends up for the year?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Are you talking about chemical, or are you talking about China in total?

Matt Summerville
Alembic Global Advisors
Q

Total IDEX China.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Okay. So, total IDEX China. So, we expected kind of mid-single-digit growth China for the year. And remember that's – China is low-single – it's kind of a 6% – 5 %, 6%, 7% of our total business. So, it doesn't necessarily move the needle in total at that level. And we have been plus or minus in that area. We have not been particularly disappointed, nor are we overly pleased. So, it's about at our expectation so far this year.

Matt Summerville
Alembic Global Advisors
Q

And then, just one last one with respect to oil and gas, and if you look across all the businesses that get impacted, whether they be in FMT, HST, or FSD. If you look at that 11% to 12% of total revenue that's in oil and gas, you mentioned that you're going to be relatively flat for the full year. Can you bracket that a little bit? Upstream is going to be down X percent, mid and down are going to be up X percent, if that'd be the case. Just a little more granularity there, please. Thank you.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

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I'm going to be spitballing a little bit here, Matt, so don't take this as gospel. But I know well exactly what's going on across our portfolio, if you look at the upstream piece. Again, that was kind of 3% of our total business coming into the year. It's more like 2% of our total business as we exit the year. So you're talking – that's down a third, things that are upstream. The midstream is going to be decent. We don't play a lot. As you get towards the pump, so to speak, we don't play a lot there.

But in the midstream, which is the bulk of our business, that's going to be kind of flattish with our aero business being strong and our mobile business which was actually strong in the first half of the year and it's going to soften here in the second half of the year, particularly as we look at truck build. So, net-net, that probably ends up being flat for the year.

Matt Summerville
Alembic Global Advisors

Q

Got it. Thanks a lot guys.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Thanks, Matt.

Operator: Our next question comes from the line of Brian Konigsberg at Vertical Research Partners. Please, proceed with your question.

Brian Konigsberg
Vertical Research Partners LLC

Q

Close enough. Thanks. Good morning.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

Good morning.

Brian Konigsberg
Vertical Research Partners LLC

Q

Hey. I just wanted to touch just a little bit more on price cost. And maybe I'm just reading a little bit too much into it, but I guess I'm used to you guys getting a little bit of net price through the year, maybe about 50 basis points net of inflation. It sounds like you're saying that's kind of more flattish now. I mean, has that deteriorated a little bit, or is it just that way we're describing it?

Andrew K. Silvernail
Chairman, President & Chief Executive Officer

A

No. I'm sorry, if you're confused by that at all, if we didn't communicate that well. No, we'll get a point of price and we'll certainly get our typical half of that net of inflation. So when it's all said and done, it will be margin accretive to us for the year.

Brian Konigsberg
Vertical Research Partners LLC

Q

Okay. So about 50 basis points for the year is still the expectation?

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Heath A. Mitts
Chief Financial Officer & Senior Vice President
A

That's right. And that's net of the material inflation.

Brian Konigsberg
Vertical Research Partners LLC
Q

Net of material and bureaucratic inflation?

Heath A. Mitts
Chief Financial Officer & Senior Vice President
A

[ph] You see, you're fairly... (51:41)

Brian Konigsberg
Vertical Research Partners LLC
Q

Labor – yeah.

Heath A. Mitts
Chief Financial Officer & Senior Vice President
A

No. Net of material inflation is how we think about.

Brian Konigsberg
Vertical Research Partners LLC
Q

Okay. Net of materials, got it. And then just secondly, just on working capital, so there's just been some discussion about, on the energy side, which may not affect you as much as some tightening in collecting receivables. Just with the industrial environment the way it is, are you guys seeing any stress kind of collections within the customer base that might pose a challenge in working capital?

Heath A. Mitts
Chief Financial Officer & Senior Vice President
A

We haven't. Now, we have a pretty conservative approach to places of the world that would tend to have in terms of more receivable risk in the emerging markets where we tend to do things on letter of credit or cash in advance. But in the more mature markets where credit terms are issued, we have not seen any degradation there. You have to remember we're dealing a lot of times with people that larger customers and people that we've done business with for many years.

Brian Konigsberg
Vertical Research Partners LLC
Q

Got it. Great. That's it for me. Thanks.

Andrew K. Silvernail
Chairman, President & Chief Executive Officer
A

Very good. Thank you.

Operator: At this time, there are no further questions in the audio portion of this conference. With that being said, I would like to turn the call back over to Andy Silvernail for closing remarks.

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Andrew K. Silvernail

Chairman, President & Chief Executive Officer

Thanks, Tim. I appreciate it. And once again, I thank everybody for participating in this call and certainly for the support and the interest in IDEX.

Obviously, we're facing a world that's challenging. It's a – we've got some headwinds here, and we expect that those will continue in the balance of the year and into 2016. But across the board, I am very pleased with how we're executing and really focusing on where we're going to put our resources in terms of organic growth and margin expansion and on the M&A front.

So I appreciate it once again, and we'll talk to you here in 90 days. Take care.

Operator: This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful rest of your day.

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