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IDEX Corp. (IEX)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to IDEX Corporation's Second Quarter 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode and a brief question-and-answer session will follow the formal presentation. [Operator Instructions] And as a reminder, this conference is being recorded.

I would now like to turn the conference over to Bill Grogan. Thank you. Please go ahead.

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.

Thank you, Brenda. Good morning, everyone. This is Bill Grogan, Chief Financial Officer for IDEX Corporation. I'm stepping in for Mike Yates this quarter and will cover the introduction. Let me start by saying thank you for joining us for our discussion on the IDEX second quarter financial highlights. Last night, we issued a press release outlining our company's financial and operating performance for the three months ending June 30, 2018 and later today we will file our 10-Q for the same period. The press release along with the presentation slides to be used during today's webcast can be accessed on our company website at www.idexcorp.com.

Joining me today is Andy Silvernail, our Chairman and CEO. The format of our call today is as follows: we'll begin with Andy providing an overview and update on market conditions, geographies and our capital deployment strategies; he will then discuss our second quarter financial results and walk you through the operating performance within each of our segments; and finally we will wrap up with our outlook for the third quarter and full year 2018. Following our prepared remarks, we will open the call for your questions.

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Before 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' filings with the Securities and Exchange Commission.

With that, I will now turn over the call to our Chairman and CEO, Andy Silvernail.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Thank you, Bill. And good morning, everybody. I appreciate you joining us to discuss our second quarter results. Let me start with a brief overview. Look, we had another outstanding quarter. As a matter of fact, I would say in my seven years as CEO it's the strongest overall quarter we've had, and has resulted in a very strong first half of the year. Just about every market that we have has shown solid growth and the economy remains strong despite what we're seeing in the global trade. I'll provide more details on market conditions and geographies in a minute.

Strong execution and continued healthy market conditions drove another record quarter for IDEX. After achieving all-time highs in orders, sales, operating income, and EPS in the first quarter, we topped that this quarter and once again hit all-time highs in each of these categories. I'm very pleased with our record second quarter and our first half operating results. I'll go into more detail shortly, but let me give just a quick overview and some highlights here.

Orders were up 9% overall, 8% organically. Sales were up 11%, up 9% organically. Adjusted operating margin was up 180 basis points to 23.6%. Adjusted EPS was $1.40, up $0.32 or 30%. And free cash flow was $110 million, up 40%. Of all the positive numbers in the quarterly results, I'm most proud of the team sustained outperformance on organic growth. The high single-digit growth rates for both orders and sales driven by solid growth across all three segments is truly outstanding. Overall, we delivered terrific operating performance.

Before I go through more specific details on financial results, let me add that I'm excited that we just announced the acquisition of Finger Lakes Instrumentation, which will fill a strategic gap and a nice compliment in our IDEX Health & Science portfolio. I'm also thrilled with the asset purchase of Phantom Controls that we made in June. These acquisitions will be a nice add to our portfolio.

Finally, we continue to live the IDEX difference daily, great teams embracing 8020 are driven by customer obsession. It's nice to watch the culture of the company embrace our initiatives and show up in our financial results.

Now let me take a minute to talk about the markets that we play in and the regions we serve. In industrial, industrial production of – momentum continues, day rates for our book and build business remained at high levels, and we see increased project activity converting to orders. In Scientific Fluidics and Optics, demand within life sciences remains positive and we continue to have a really, really nice performance overall.

Energy, we've had a rebound in this market, midstream oil and gas has picked up and upstream remains strong. In semicon, the global markets have remained strong really all year and we look forward to that strength continuing. In Agriculture, the markets continue to perform and the OEMs have affirmed the outlook for the balance of the year. We do have some concerns here relative to trade, but we'll have to monitor that going

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forward. In the Municipal Markets, the markets remain strong. The new product development in Waster has been a really nice benefit for us, and emerging markets have done well. Excuse me.

Now let's look at the geographies. Overall things are going well for us in North America; Europe continues to be solid; and in Asia in both China and India, we see things going very well. In summary, what we saw and began to experience in 2017 has accelerated in 2018. Thank you.

One thing I'd like to talk about for a minute is what we're seeing with tariffs. Based on the enacted tariffs, our best estimate is that we're going to see $4 million to $6 million of impact in 2018. We continue to look at all of our options including pricing and alternative sourcing strategies. Excuse me. And we've done a really job of overall balancing the overall margin impact to the business.

Let me take a second and talk about inflation. We are starting to see the higher impact from inflation. And – but we've been very successful in mitigating the uptick through productivity and price realization. With that said, inflation remains a concern and the team is doing a very, very well – a very, very good job of monitoring this and impacting it on a go forward basis.

Let's turn to capital deployment. I'd like to take a minute to recap our capital deployment strategy. As always, organic growth remains our number one focus and the team is dedicated to overall targeted organic growth and new product development initiatives. This is evidenced by our outstanding organic order and revenue performance. With M&A, it remains a priority for us and we continue to evaluate a lot of opportunities. We're going to remain disciplined and focused on delivering the best possible returns to our shareholders. Our balance sheet is strong and when the right deals come along, we'll capitalize on it.

Speaking of the right deals, I'm excited to welcome both Phantom Controls and Finger Lakes to the family. The assets of Phantom Controls will mesh nicely with our current Fire Suppression business and help accelerate our water-flow strategy. And on Monday, we expanded our Health & Science portfolio by adding Finger Lakes Instrumentation. This will be a nice add to our overall fluidics and optical business. We'll work to quickly integrate both of these acquisitions and bring them into the family in a short order.

In terms of share repurchases, during the quarter, we deployed approximately $20 million, we repurchased 147,000 shares of stock. We remain committed to our strategy, repurchasing shares when it will create long-term shareholder value. In the second quarter, the board approved a $0.06 increase in our quarterly dividend which equated to a 16% increase. This resulted in a $33-million dividend payout to our shareholders in the quarter.

All right, let me turn now to our results here in the second quarter. I'm on slide 4. Q2 orders of $639 million were up 9% overall and 8% organically. Again, the strong order growth from all three segments, the strength in the first half orders provides us a confidence for the second half. Q2 revenue of $634 million was up 11% overall and 9% organically, driven by positive results in all three segments. FMT was up 10%, HST was up 8%, and FSD was also up 8%. We built $5 million of backlog in the quarter on top of the $20 million that we built in the first quarter.

We expanded Q2 gross margins by 50 basis points to 45.3%, primarily due to production efficiencies and volume leverage partially offset by investments in engineering. Q2 operating income was $149.8 million adjusted for approximately $2 million of restructuring expenses, that was up 20% compared to the prior period. Q2 operating margin, adjusted for the $2 million of restructuring was 23.6%, up 180 basis points year-over-year.

Similar to the first quarter, the majority of the restructuring expenses were within HST and are associated with our investment in the new Optics Center of Excellence in Rochester, New York. Consolidated operating margin was

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also impacted by higher corporate cost, which is mainly due to $2.2 million stamp duty in Switzerland associated with the restructuring of an intercompany loan.

Q2 net income was $170 million, resulting EPS of $1.38. Excluding the restructuring expenses, EPS was $1.40, an increase of $0.32 or 30% over last year. Our Q2 effective tax rate was 21.7% which is lower than the 26.1% in the prior period, this was mainly due to the enactment of the 2017 tax reform at the end of last year. The 21.7% – excuse me 21.7 second quarter ETR was 80 basis points favorable to our previously guided amount; this is driven by a continuous effort to modify our tax strategies and to the tax reform. The positive EPS impact of our lower ETR versus our guide was basically offset by the stamp tax I mentioned earlier.

Overall, we had a $0.09 operational beat versus the midpoint of our guide. Free cash flow was $110 million, 101% of adjusted net income, and up over 40% from last year. And finally, flow through is another great story, over 40% to sales.

In regards to our balance sheet, it's very healthy. We have gross debt of 1.4 times, net debt of 0.6 times, and well over $1 billion in capital to deploy.

Let me now turn to the segment discussion, I'm on slide 5 starting with Fluid & Metering. FMT continues to put up strong numbers both from an order and revenue perspective, Q2 orders were up 6% overall, 7% organically. Q2 sales were up 10% overall and organically. Op margin, adjusted for operating – for restructuring was 29.5%, up 240 basis points over the prior year, mainly due to volume leverage and productivity.

The Ag business as I mentioned continues to be strong and we are watching out for the impact of tariffs. In Industrial Fluids, the Pump business is very impressive. It had record order sales. The U.S. distribution market is solid and day rates for book and ship continue to improve. Increased oil prices are driving continued strength in oil and gas, as well as the business for our LACT. Valves, our targeted growth initiatives in Europe and China have performed well in the quarter. And in Water, we're well-positioned driven by new products. In Energy, new product development is progressing and expected to provide future opportunities, and the project funnel is solid for the back half of the year.

Let's move on to Health & Science, I'm on slide 6. I'm very pleased with Health & Science results in the quarter. Q2 revenues were up 11% overall, up 8% organically. Orders were up 5% overall, but only 2% organically. HST had a tough comp due to some very large project wins last year in MPT. Just to remember, HST orders last year were up 11%.

Excluding restructuring expenses, adjusted operating margin was 23.6%, an increase of 100 basis points in the quarter, mainly due to higher volume and productivity. As I stated on our last call, 23% to 24% operating margin is much closer to what I expect in the segment to be performing. And I'd like to commend the team once again for the improved performance.

In life science and optics, the IVD, Bio end markets continue to over perform. The recent acquisition of Finger Lakes Instrumentation will continue our expansion within this market. We're encouraged to have these technologies that Finger Lakes will bring and excited to bring them into our fluidics, microfluidics and optical illumination and detection business.

In Sealing Solutions, the semiconductor market remains very robust on a global basis. Transportation and oil and gas are also doing well. In MPT, the funnel activity remains positive, but if you'll recall we do have a pretty tough comp here in the third quarter in MPT. In HST industrial, demand remains overall very strong.

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I'm now moving on to our final segment Diversified on slide 7. Q2 orders were up 21% overall, 18% organically. Dispensing did have an easy comp as we had a large project last year pushed to the second half. But even if we exclude that, orders would have been up double-digits for the quarter. Revenues were up 11% overall, 8% organically. Excluding restructuring expense, adjusted operating margin of 28.1% increased 300 basis points. This is mainly attributable to significant volume upside along with productivity.

In Dispensing, North American and European markets remain strong and steady with increased orders and project activity. Emerging markets remained strong from robust market growth and new project development penetration.

In Fire & Safety, rescue is positive across the globe and we've seen project activity pick up in India, China, and the Middle East. And our Fire OEM and Muni business is steady. As I mentioned earlier, we're very excited to incorporate the recently purchased assets of Phantom Controls. And finally, margins continue to improve at both Akron Brass and AWG, they are ahead of expectations.

At Band-IT, last but not least, we've experienced a double-digit organic order and revenue growth driven by share gains and overall strong demand across the globe.

Let me now conclude with some additional details to our 2018 guidance for the quarter and for the year. I'm on slide 8. In Q3, we're estimating EPS in the range of $1.29 to $1.32 with organic revenue growth in the range of 6% to 7% and operating margin of 23%. The Q3 effective tax rate is expected to be approximately 22.5% with an estimated less than 1% top line headwind from FX based on the June 30 rates. Corporate costs are expected to be approximately $20 million.

Turning to the full year, we've increased our full year EPS guidance to the range of $5.27 to $5.35. Full year organic revenue growth is expected to be approximately 7%. So a nice increase in organic revenue guidance as well. If you remember, we've guided before at 5% to 6%. Full year operating margin is expected to be in the range of 22.5% to 23%. For FX, it's going to be a 1% tailwind for the year based on the June 30 rates. But we will have headwind in the back half that – it's worth about $0.06 to us.

The full year effective tax rate is going to be about 23%, but we'll see what happens here with tax reform. Capital expenditures are anticipated to be around $45 million. Free cash flow will remain strong at 110% of net income. And corporate costs should be in the range of $76 million to $80 million, that's up around a little more than $2 million from the stamp tax that I mentioned before. Finally, our earnings guidance excludes any associated cost of future acquisitions or restructuring.

With that Brenda, let me turn it over to any questions people have.

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QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] Our first question comes from the line of Steve Winoker with UBS.

Steven Winoker
Analyst, UBS Securities LLC

Q

Hey, thanks and good morning, all.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Hey, Steve.

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.

A

Hey, Steve.

Steven Winoker
Analyst, UBS Securities LLC

Q

Hey, great to see this level of growth and I agree it's impressive. I would love to get a sense on that FSDP organic 18% increase on the order side. To what extent are these kind of one-time, lumpy orders, pull forward anything else, so should we be expecting this to fall back to company mean rest of the year? Or are you – I mean, I think you're up against high single comps, it wasn't easy there, so.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So overall, even if you take out some of the larger orders that we saw, you're looking at a double-digit order increase. We did have some project orders that will ship in the back half of the year and even in the first part of next year. But the activity was very, very strong. I would not expect it to remain in the double-digit territory. That's too ambitious. But overall, strength is pretty good and it's in every one of the businesses, it's not in a singular business.

Steven Winoker
Analyst, UBS Securities LLC

Q

All right. And are – and that your forward guidance and – implies, I think fourth quarter at least some deceleration.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Steven Winoker
Analyst, UBS Securities LLC

Q

Again, you got, I think 9% comp last year.

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Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah.

Steven Winoker
Analyst, UBS Securities LLC
Q

Is that all it is? Is there something more to it? Are you – is tariffs playing into your thinking here?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

No, no. The tariffs as we mentioned is going to have some impact certainly into the cost structure of the business. We think about $4 million to $6 million. We haven't factored in a slowdown for overall global growth. We just have much tougher comps as we go forward.

As I mentioned last quarter, we really start to see the acceleration at the back half of last year and I don't think we're going to decelerate sequentially, but at the same time those comps just get tougher.

Steven Winoker
Analyst, UBS Securities LLC
Q

Okay. And then just one more if I could. These acquisitions you mentioned, the most recent ones sound pretty interesting.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah.

Steven Winoker
Analyst, UBS Securities LLC
Q

Are there return on invested capital – plan going forward, changing significantly, I mean how should we think about the financial side of them and any kind of call out on the strategic front would be helpful?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah. The size is relatively immaterial today, both of them are really technology place, when you get right down to it. Phantom really helps us overall with the integration of being able to bring together all the most valuable components on a fire truck. It optimizes productivity for firefighters and safety. And the real benefit for us of Phantom is going to be pull through revenue from other parts of the business over time. It's a really neat set of technologies. It's very, very well protected with intellectual property. So we're very positive on that.

Finger Lakes that we just announced. It's fundamentally a camera technology that allows us to integrate that into our optical systems. Right now, we're having to buy off the shelf componentry, which as things get smaller and more efficient, gets more difficult to do. You really need to be able to integrate that yourself. And so it's a technology purchase that is right down the road from our current business in Rochester and will go nicely into our Center of Excellence.

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Steven Winoker
Analyst, UBS Securities LLC

Q

Very helpful as always. Thanks, and good luck.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Thank you.

Operator: And our next question comes from the line of Deane Dray with RBC. Please go ahead.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning, everyone.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Good morning.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Hey, maybe we can start on price cost in the quarter and then kind of separate both.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

So with pricing, how much did pricing contribute, what's the plan on price increases? And on the other side lots of material cost, inflation, labor, how are you seeing that and then the offsetting of tariffs?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So, first on the pricing side, we got a little more than 1% in the quarter which is a nice uptick from where we've been. And that's really just our sustaining strategies around being out in front of what we saw even last year at this time is a pickup in inflation. So, we've been more aggressive there generally and obviously the environment makes it easier to have those conversations with integrity with customers.

The inflation side has also picked up, we've kept our spread, we said we've historically shot to have somewhere of 20 to 30-point spread on price versus inflation and we've kept that. And so, we are seeing inflation pick up and it's really everywhere. It's material, it's labor, it's universal, and we expect that to continue. And obviously, tariffs don't help that situation. We're having those conversations with our customers, we're trying to again be ahead of everything. What you don't want to be is the 20th person in line having that conversation about how tariffs have impacted the business.

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I think that the threat – and I've been talking about my concerns about inflation for a while. The threat is that in the short-term, the tariffs cause – are really kind of gasoline on the inflation fire. In the long-term, it's a flip side, they actually causes a deceleration in growth. But in the short-term, we could see that impact. And we're balancing that with a combination of actual price increases and then in some cases what I would call surcharges, where that will roll back off if tariffs roll back off and those are broken down about 50-50.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Good. That's really helpful. And then maybe just on the pricing side, we've heard some descriptions from CEOs about pricing effectiveness, and what is that dialogue? Because you are at the higher end of the component technology...

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

...and you've got more pricing power. So when you put pricing through, are you getting pushback, are you getting all the price? Just some color there would be helpful.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

You never get all of it. I think realization is probably somewhere in the 50% range over time of what you go to the market with and what effectively sticks. And so – and it's easier to have those discussions in distribution than it is with – obviously if you have long-term OEM contracts that's a much more difficult conversation to have. And so we'll typically get more price in if we were looking at FMT and Diversified and we'll get less price overall in HST.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Got it. And just last question on the outlook and kind of a follow-on to Steve's question is, when you look at it -your kind of key barometers and we've talked about this before, whether it's gas and Band-It and Warren Rupp, just – maybe just take those kind of leading indicator businesses and what do they tell you about the pace of short cycle industrial demand and how long this demand growth is sustained.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

They're very positive. If you look at our industrial businesses, our industrial fluid businesses, they are the strongest of our businesses overall.

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.

A

Yeah.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

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So they're signaling very positive things. We don't have any signs that that necessarily is going to slow. I am obviously very hesitant with what the overall trade discussion means to the global economy. And look if things start to slip, they'll show up fast in those businesses, gas to Warren Rupp in particular, Band-It industrial. You'll see that relatively quickly if the global economy starts to slow.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's really helpful. Thank you.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Thank you.

Operator: And our next question comes from the line of Allison Poliniak with Wells Fargo. Please go ahead.

Allison A. Poliniak-Cusic
Analyst, Wells Fargo Securities

Q

Hi, guys. Good morning.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Good morning.

Allison A. Poliniak-Cusic
Analyst, Wells Fargo Securities

Q

Can you just go talk through I guess capacity both from the supplier side and your side with growth at this level. Any concerns that your suppliers won't be able to keep up, that you're going to have to adjust for or that you've been adjusting for?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah, it's real, Allison. So let me talk about it from our perspective first. From our perspective, we really don't have a lot of physical constraints. If you look at buildings, machinery, you don't have a ton. We are definitely increasing our overall automation or semi-automation, we're doing that mostly through machining centers. And so we're not really constrained in that way.

The biggest constraint for us and for everybody is people, highly skilled people. And that's going to continue and that's going to get more difficult as time goes on. And I do think that that's what's going to drive across the globe more investment in automation and in semi-automation.

In terms of our supply chain, we absolutely are seeing issues and we have been for some time. If you look at lead times they have extended. As we talked about last quarter, we built some inventory last quarter because we had seen the lead times extend and we are trying protect our customers. And I think we've generally done a pretty good job with that. But there's really no way to avoid it in this environment, and that's why I think we're starting to see the capital cycle play out the way it is, because you are seeing some constraints in global supply chain.

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Allison A. Poliniak-Cusic
Analyst, Wells Fargo Securities

Q

That's great. And then I just want to touch on the full-year margin outlook.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Allison A. Poliniak-Cusic
Analyst, Wells Fargo Securities

Q

You're still keeping to that low end of the range. Is there something mix related at least to be thinking about in the back half that could bring that number down a little bit from what you did in Q2?

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.

A

No, I mean, when you look at our first quarter margin rate and second quarter, the average there is a little bit over 22.5%. So, no major mix concerns. I think we will probably be closer to the top of that range, but I want to give ourselves a little bit spread depending where things go in the back half.

Allison A. Poliniak-Cusic
Analyst, Wells Fargo Securities

Q

Perfect. Thank you.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

You bet, Allison. Thank you.

Operator: Our next question comes from the line of Scott – excuse me – Nathan Jones of Stifel. Please go ahead.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good morning, everyone.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Hey, Nathan.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

I guess Andy, you guys have always been a prepare for the worst and hope for the best kind of company in the way you run the businesses over there.

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Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yes.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.
Q

With growth coming in pretty significantly higher than you'd planned at the start of the year, are you seeing any need to add kind of back office support functions, G&A kind of functions, corporate expense kind of functions back into the business to support this higher level of growth? And then maybe how you're thinking about that with your opinion that maybe tariffs will slow down growth – global growth, maybe the growth doesn't stay at that – as high as that has been that long?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

So, we've been – we have very cautiously added what I would call overhead to the business. If you look at our overall head count across the globe, it's only modestly changed in the last couple of years. And so, we've gotten a lot of productivity there. Where we're going to add people and where we have added people are at the businesses. There is really no need to add a bunch of people at corporate as you know, it's a pretty small group, anyway it's pretty much IT, finance and HR, otherwise everything is at the businesses. And so, that's where we're going to focus our investment. I don't really see a big need for that to change.

The one thing that I've talked to a lot with people about is unlike five years ago or 10 years ago where there was a lot of fat to trim in the downturn, that doesn't exist today. And so in the next downturn which will come, I think us and everybody else are going to have to be very, very smart about how we deal with that and in terms of people in particular, right. So the people shortage that exists across the globe of really of skilled folks is going to get exacerbated here. It's not going to get better. And so when you think about a downturn, you're going to approach it differently than you've approached it in the past, and you're going to do everything you can to actually be ahead of the curve and make sure that you don't hurt your great people.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Fair enough. And then I know you guys have largely or pretty much exclusively funded all of the internal growth opportunities that warrant funding. You've got higher growth here, you've got more income here. Are there other projects that you can go a little further down the list for that potentially don't have as good of returns but still good returns that you would look at funding? Do you have enough bandwidth, enough people power to continue to do that?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

I feel – I've said this many times, I feel very confident that we're funding the things that are in front of us that make sense. If there's any limitation, again it's people, right. I don't think that's a big limitation for us but that's the biggest thing across any of our businesses is great people make a huge difference and that's why we spend so much time on it as a corporation.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.
Q

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Then maybe just one more on the – following up on Allison's on the supply chain. You're talking about seeing lead times stretch out, tightness in the supply chain.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yes.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Are you starting to see suppliers look to cash in on that and raise prices contributing to inflation, is that something that you're expecting to see, are you expecting it to get worse, any color you've got there?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

We've absolutely seen it. We are – we work it constantly both in mitigating with our supply base and diversifying across suppliers, in passing on price where we need to, it's there, right. So if you went back two years ago, pricing into our supply chain was effectively zero, right, it was nothing and we were getting positive productivity. Today we're in the eight-tenths of a point range that we're starting to see. And so that's a meaningful uptick across our businesses and there's really at this – at this stage where we're seeing demand continue to be strong, there's no reason that's going to change unless our leadership shoots us all in the foot here.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay. Thanks very much for your time.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yes.

Operator: And our next questions come from the line of Brett Linzey with Vertical Research. Please go ahead.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Hi, good morning, all.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Hi, Brett.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Hey just wanted to come back to FMT margins. I mean really continue to impress here with further expansion in Q2. I guess with H1 and H2 sales relatively balanced, I mean is there anything in the back half in terms of mix or stepped up investment that would suggest or point to profit margins stepping down sequentially, H1 verse H2? And then I guess what's the expectation for that segment for the full year?

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Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Bill?

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.
A

Well, I would say that within FMT there's some seasonality, where sequentially the revenue will go down a little bit here in the back half, and example Banjo seasonality, they're more first half related and they're one of our highest margin businesses. So it's not a huge impact, but you'll probably see the margins not be as robust as they were in the second quarter but still within that mid to upper 28% range.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah. I mean just across the board, one of the major drivers of profitability for us has been the strength of a handful of industrial businesses that have superior contribution margins to the rest of the company and have pricing power. And so, we're very mindful about that and so as you look at sequential changes, that flow through is big positive or negative. And so, you certainly have to watch that quarter-to-quarter.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Okay. And then in the release I mean, you talked about the M&A pipeline being active, I guess how would you delineate between what's actionable at current valuations in returns versus relationships that are just being cultivated? And do you see anything breaking free here in the near term?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

We've been awfully close on some things. Just recently, we walked away from almost a $0.5-billion deal and we walked away on price, we kind of got down to the last couple of players and we walked away just with the discipline that we brought to bear.

So, it certainly isn't a lack of opportunities and it isn't a lack of effort. It really is the pricing environment. And so, we've been very disciplined, we'll continue to be disciplined. The stuff we're cultivating that really doesn't change quarter-to-quarter, year-to-year. That kind of magnitude looks the same. It really is what's driven by what's coming to market. And we've seen a lot of activity this year coming to market and we expect that to continue with these elevated valuations.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Okay. And just maybe one more on new product vitality. You guys have taken share here for a couple of years on orders and sales. What percent of sales are from new products over the last three years today? And I guess what's the right number as you guys climb the technology curve in many of these businesses, where does that target need to be?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

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Brett, we stopped measuring new product vitality some time ago. And the reason for that is – what I found is it tends not to be a real number. It's not something that's easily auditable and it also creates a lot of bad incentives for people to rename things, to increase complexity and stuff like that. So, we tend not to do that.

The other thing is – and really the beauty of IDEX is we kind of have a very, very long product lifecycles, things that last decades and have incredible durability. And so, we don't want to kind of shoot ourselves by accelerating change that doesn't need to be changed. That being said, we are really aggressive around new product development. And if you look at the growth that we're having, the 9% organic growth, about half of that is the market and about half of it we're driving. And I would argue that most of that is coming from new product development.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC

Q

Okay. Makes sense. Great. I'll pass it along. Thanks.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Thanks.

Operator: Our next question comes from the line of Joe Giordano with Cowen and Company. Please go ahead.

Joseph Giordano
Analyst, Cowen & Co. LLC

Q

Hey, guys. Good morning.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Good morning, Joe.

Joseph Giordano
Analyst, Cowen & Co. LLC

Q

Hey, so most of my stuff has been asked already but Andy, I just wanted a – you're a pretty conservative guy. And you generally like the last – god knows how long now, you guys come in above the high-end of what you're guiding pretty consistently but this quarter, the magnitude of that was even more than...

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Joseph Giordano
Analyst, Cowen & Co. LLC

Q

... it has been. And what were the couple of things that – you obviously are not trying to get like top ticket with your guidance, but what were the couple of things that like wow, this is a lot better than what we kind of thought?

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Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

So, you come into the quarter with about 50% of the quarter booked and I don't know Bill, was that changed by a couple of points?

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.
A

Yeah.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

...here and there.

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.
A

In most, yeah.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

It doesn't change by a lot. So, what happens in the quarter is you get more book in term business. And that really happened and it happened across the business. It wasn't one or two businesses that drove it. It really was across the portfolio.

And so the overall economy – my expectation was that you were not going to see a sequential acceleration in the second quarter. I thought that that would start to modulate and we didn't see it. And so that did surprise us a little bit. So a stronger book in term business, strength sequentially that we hadn't really expected. And I do think that that does slow down, right. We're not going to – we've now had what, six or seven quarters of sequential acceleration?

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.
A

Yes, six.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah. So that's going to slow down there's no doubt about it. And we just – I think we were probably a quarter too early in making that call.

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.
A

Yeah, I mean the stat we look at internally 60% our businesses were up double digit. So that's pretty broad based across the three external segments to have that magnitude of growth across the portfolio.

Joseph Giordano
Analyst, Cowen & Co. LLC
Q

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Would you say like – so it's fair to say that you're not extrapolating that kind of acceleration into your updated guidance then?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

The third quarter is going to be stronger than we thought before, but we don't see it accelerating from the second quarter like we saw the second quarter accelerate from the first. Seasonally, that tends to be a weaker quarter for us anyway and I just don't think that the growth is going to accelerate. I don't suspect it's going to get weaker unless again it's driven by some of the overall trade issues and whatnot. But I still think it's going be pretty robust.

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.
A

Yeah, I would say relative to our last guide we're more confident in the back half...

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah. Yeah.

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.
A

...and what the growth numbers are going to be.

Joseph Giordano
Analyst, Cowen & Co. LLC
Q

Okay. And last for me just on the Diversified segment on the margin. I mean that segment is still hard to model just given the size of orders.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah.

Joseph Giordano
Analyst, Cowen & Co. LLC
Q

Like what's a – what should we be thinking about for the second half there?

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.
A

I think 26% to 27%, I mean it's – at the current growth rates, it's been able to lever extremely well, and with the two acquisitions Andy mentioned earlier, the progress we've made on the integration front they've well surpassed our expectations. So it's going to get much more close to where they were pre-deal.

Joseph Giordano
Analyst, Cowen & Co. LLC
Q

Thanks, guys.

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Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Thank you.

Operator: And our next question comes from the line of Scott Graham with BMO.

R. Scott Graham
Analyst, BMO Capital Markets (United States)
Q

Hi, good morning. Can you hear me?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Hey, Scott.

R. Scott Graham
Analyst, BMO Capital Markets (United States)
Q

I'm getting some interesting questions here, kind of like, I'm going to ask a similar one on kind of how you got to doing it. The organic continues to shine through and somehow it even got better. So I guess, my simple question is for my simple mind is, are you willing to maybe share a little of that secret sauce here, Andy?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah.

R. Scott Graham
Analyst, BMO Capital Markets (United States)
Q

Can you tell us where the funding of the – where the sales opportunities are most prevalent and which one's you're funding maybe by segment? Can you maybe get a little bit more specific on how this is – you're doing this market share of this land grab, so consistently...

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah.

R. Scott Graham
Analyst, BMO Capital Markets (United States)
Q

...maybe you can give us a little bit more detail if possible?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

I'll give you a relatively boring answer. If you actually look back, this is kind of three years in the making. If I go back, we got really aggressive – go back to 2014, 2015, we got very, very aggressive about segmenting our businesses. And so, as you think about what we've done with using the 8020 principles around segmenting our businesses, segmenting our markets and really deeply understanding where the profit pools were, where we had advantage, where we didn't have advantage. And really aggressively moving resources around the company.

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I mentioned earlier that we haven't seen a big change in head count here in quite some time. And the reason for that is because we – over three or four years, we have really aggressively moved people and investment to the areas within businesses, and I'm talking about segmenting to the product level where you're moving people and resources to where we have distinctive advantage.

And so, I'll give a great example of that. If you look at our Dispensing business, if you went back six years, seven years ago, we had real question marks about that business, about the viability of that business and whether or not it should be in the portfolio. And if you look at what Eric Ashleman and the team have done, Eric is our Chief Operating Officer. We have fundamentally refreshed that entire product line. We exited a handful of product lines really aggressively. We entered a previously non-existent market segment with the X-Smart. And have – and again, as I said refreshed the entire product category and Dispensing has turned into just an outstanding business for us.

That same example can be used across IDEX, you could go business-by-business. We opted to sell six businesses. We – as you know, we had been reticent to sell anything in the past. And we got out of businesses that we didn't think we had an advantage with. We exited four – Bill, I want to say three, four years in a row, about 1 point of organic growth...

William K. Grogan
Chief Financial Officer & Senior Vice President, IDEX Corp.

A

Yes.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

...each year that didn't really show up in the numbers per se, because we didn't talk about it a ton. But if you're talking about over a period of time, more than $100 million, actually probably more like $150 million if you include what we got out of in Optics. And – that we exited and so – and we exited businesses where we didn't have an advantage, a distinct advantage. And so it's a relatively boring answer. It's a lot of very scrappy, in the dirt work, and in our business things move relatively slowly and I think what you're seeing now is you're seeing that hard work pay itself off.

R. Scott Graham
Analyst, BMO Capital Markets (United States)

Q

Okay. Any other – that was comprehensive. Thank you. It just – would it be possible for me to ask you sort of if you gave us a Dispensing example, can you give us an example maybe in Pumps?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Oh, sure. And if you – let's use – Viking is a great example. The Viking business has always been a flagship business for us. And what I would say is we had a distinctive culture where we said yes to everything. So you had unbelievable modifications that we were doing in that plant. We had lead times that were ridiculous, we really relied on the Viking brand. Our volumes were modestly growing at best for five, six, seven years, and that exact playbook that I walked you through a moment ago, in the last three years at Viking we've done the exact same thing.

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And even if you take away the incredible strength in the markets that they're in, Viking is doubling their market growth rates right now, the LACT business has been outstanding. We've entered multiple segments of that market with technologies that have a really distinctive advantage versus the competition. Our overall lead times, we've cut them in half in three years and so our ability to be incredibly aggressive in the marketplace on service is unique. And when you're in an environment like this, lead times really matter and so we've been able to do those sorts of things at Viking.

So and I could – I mean you could go across the business, I could give you examples of that in HST, I could give you examples of that ins gas, you can do a business-by-business and that's the key, right, there is – there's no IDEX magic here, right. Except to say, we have done this across our portfolio of 40 businesses and we've made really tough capital and people allocation decisions around where we have distinctive advantage.

R. Scott Graham
Analyst, BMO Capital Markets (United States)

Q

Got it. Hey thanks a lot. Great quarter.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Thank you, Scott.

Operator: And our next questions come from the line of Walter Liptak with Seaport Global.

Walter Scott Liptak
Analyst, Seaport Global Securities LLC

Q

Hi. Thanks. Good morning. And I'll say congratulations on the organic growth too, especially the consistency.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Thank you Walt.

Walter Scott Liptak
Analyst, Seaport Global Securities LLC

Q

I wanted to ask – just a clarification on a data point, when we were talking about market share versus market growth, I thought I heard you say that you attribute half the growth to market share and the other half to the market. Is that right?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. I would use – market share is not exactly the right term, because in some places we're literally entering businesses that we haven't been in, so you could call it share. But it's half market growth and it's half new business that we are winning distinctively.

Walter Scott Liptak
Analyst, Seaport Global Securities LLC

Q

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Okay. All right. Got it. And realizing that a lot of your business is quick turn and there's low visibility, there is some project work and I wonder if you could talk a little bit about where – what you're seeing from projects? Is there a funnel that's building, maybe pricing? And then specifically, I think you called out the LPG truck build...

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah.

Walter Scott Liptak
Analyst, Seaport Global Securities LLC
Q

... where are we in that cycle? Is this something that – why and how long does that go?

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah, well let me make sure I got that, so you had a question on project work generally, pricing, and then LPG? So let me make sure I get all three of those.

Walter Scott Liptak
Analyst, Seaport Global Securities LLC
Q

Yeah. Okay. All right, thank you.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

On project work, yeah it's picked up. As you know we don't tend to have a lot of really large projects, they tend to be in a couple of hundred thousand to $5 million range generally. And if you went back 18 months, 24 months what you would have heard us say is that we were really kind of living on date book and term business, and we started to see project work come back 18 months, 24 months ago and that has continued to improve. So that has absolutely been the big change here if you look over the last couple of years where project work has come back and we've certainly seen that.

In terms of pricing, Walt, I'm not exactly sure what your angle was on pricing if you can clarify that for me, what was the question?

Walter Scott Liptak
Analyst, Seaport Global Securities LLC
Q

Just sometimes the longer project work goes out to bid and there're multiple rounds of bidding to try and get the price down.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.
A

Yeah. Okay. That certainly is the case. We tend to be a really small part of these projects and so we don't tend to see a lot of price pressure in there, that's not something that would be particularly mentionable here. So I would say no, it's not been a particularly big deal and the overall pricing environment for anything right now is much more favorable than it's been in a long time.

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And then finally on LPG. Yes, the truck builds have improved. Where are we in the cycle? I think we're actually still early-to-mid stage in that that really just picked up this year if you look at it. Now truck builds overall as you know are astronomical. I think the U.S. has 430,000 class A trucks if I remember right. It's a big number. And obviously we're not as to tie to that, but overall that industry has seen major expansion. But I would say, we're still early-to-mid in the LPG truck build.

Walter Scott Liptak
Analyst, Seaport Global Securities LLC

Q

Okay. Great. Thank you.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

A

You bet, Walt.

Operator: Thank you. We've reached the end of our question-and-answer. I'd now like to turn the floor back over to management for any closing comments.

Andrew K. Silvernail
Chairman & Chief Executive Officer, IDEX Corp.

Well, first just thank you for following IDEX and the work that you do here with us. Most importantly, I really want to thank our teams. The operating teams in the business led by Eric Ashleman have just been outstanding, the results that we get is due to them. And I'm very, very appreciative of what they bring to the table each and every day.

So again, I appreciate your time and look forward to talking to you here in 90 days. Take care.

Operator: This concludes today's teleconference. You may disconnect your lines at this time, and thank you for your participation.

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