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IDEX Corp. (IEX)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the IDEX Corporation Second Quarter 2019 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] As a reminder, this conference is being recorded.

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

Michael J. Yates
Chief Accounting Officer & Vice President, IDEX Corp.

Thank you, Mellissa. Good morning, everyone. This is Mike Yates, Vice President and Chief Accounting Officer for IDEX Corporation.

Let me start by saying thank you for joining us for a discussion of 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, 2019. And later today, we will file our 10-Q. 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 Bill Grogan, our Chief Financial Officer. The format for our call today is as follows: we will begin with Andy providing an overview and an update on market conditions, geographies and capital deployment. Bill then will discuss our second quarter financial results and

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walk you through our operating performance within each of our segments; and finally, Andy will wrap up with an outlook for the third quarter and the full year 2019. Following these 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 13684163, or you may simply log on to our company's homepage for the webcast replay. Before we begin, a brief reminder, today's call may contain certain forward-looking statements that are subject to the Safe Harbor language in last night's press release and in IDEX's filings with the Securities and Exchange Commission.

With that, I'll now turn the call over to our Chairman and Chief Executive Officer, Andy Silvernail.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Thank you, Mike, and good morning, everyone. I appreciate you joining us to discuss our 2019 second quarter operating results.

Let me start with a few summary points on the results. Q2 was solid and I'm very pleased with the team's performance in a choppy economic environment. Bill's going to walk you through some financial details in a bit. But overall, we delivered 3% organic growth in the quarter, our 10th consecutive quarter of organic growth. The 3% was slightly below expectations but considering the lingering trade tensions and the uncertainty in the macro environment, I was happy with the result.

Our price and productivity initiatives continued to drive outstanding margin and capital return, regardless of commercial environment, and we delivered another record EPS in the quarter. As we look at the balance of the year, we're confident in our ability to execute in times of volatility. As such, we're raising the low-end of our full year guidance by $0.08, our guide is now $5.78 to $5.85 per share.

Finally, before I go into details, I want to take a moment to welcome Velcora Holding and its two product lines, Roplan and Steridose to the IDEX family. We're very excited about the possibilities this acquisition brings to our Sealing Solutions platform, and I'm confident that the acquisition will prove to be a great addition to our portfolio.

With that, let me start the call with a look at the regions we do business in. The overall global economic output remains uncertain. Companies are employing a wait-and-see approach and slowing down larger project activities as they wait for some resolution to the various geopolitical situations across the world. We believe that the underlying fundamentals in North America remain strong due to higher levels of employment and expanding wages. Markets continue to grow, but at a slower rate versus the first quarter. In Asia, there are some pockets of strong performance, but the overall Asian economic performance decelerated due to uncertainty driven by the ongoing trade conflicts in China and the election cycle in India. Finally, the Eurozone was flat year-over-year. We see pressure in Germany, as auto, tooling and general industrial markets softened, given the apprehension in the UK as the future of Brexit is still unknown.

All right. Let me turn to the markets we serve. The industrial markets are generally performing well, driven by OEM and project wins. However, we're seeing softness in daily distribution orders and project closure timing is becoming harder to predict despite a strong funnel. Demand continues to be robust across key life science markets. Strong performance continued in IVD/Bio as our partnership with our customers continue to drive innovation and bring new products to market. The energy market is relatively flat with strong North American truck demand and good performance of commercial aviation, offset by lower LPG project volume.

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U.S. ag continues to be soft. Our overall farmer sentiment is low with continued tariff impacts and the challenging 2019 planting season. OEMs are reacting to the slowdown with extended mid-year shutdowns. Municipal markets in North America remain stable. We see some slowness in Europe, where political uncertainty is leading to project delays. And the China markets are softening, but India remain strong.

The semiconductor market continues to be driven down by high inventory levels of memory chips as well as lower consumer sales of smartphones. We do not expect this market to pick up in the back half of the year. Finally, the slowdown in global light vehicle sales drove softness in our automotive exposure especially in China.

Okay. Let me switch to capital deployment. As I mentioned earlier, I'm very excited to welcome Velcora Holding and their Roplan and Steridose product lines to the IDEX family. These businesses will mesh nicely with our Sealing Solutions, our portfolio and will complement our current product offering. We deployed $137 million of capital on the deal and paid about 13 times 2019 EBITDA. We expect this deal to achieve double-digit cash on cash returns in the near future.

We're still working through the purchase accounting associated with the transaction, but we don't expect the deal to be material to our 2019 adjusted EPS. As usual, we'll work closely with their teams to integrate the business into the IDEX family and we look forward to the long-term returns they'll provide.

M&A continues to be a priority for us and the funnel remains strong. Our teams continue to evaluate several deals as we continue to look for high-quality assets to add to the portfolio. In addition to this, in the quarter, we repurchased $3 million of stock at an average purchase price of $155 and we returned $38 million to shareholders via dividends.

With that, let me pause here for a moment. I'll turn it over to Bill who's going to talk about the financial results and the segment discussion.

William K. Grogan

Chief Financial Officer & Senior Vice President, IDEX Corp.

Thanks, Andy. I'll start with our second quarter financial results. I'm on slide 4. Q2 orders of $628 million were down 2% overall and flat organically. Each of the segments were flat year-over-year. I'll get into more detail when covering the segments, but I would say there are three main drivers for order performance.

First, the softness we are seeing in ag, semi and auto impacted orders by about 150 basis points. Secondly, the unresolved trade conflict and continued geopolitical uncertainties are creating caution in the markets and we are seeing customers pause on large project investment across the segment. And finally, we are comping back to back years of over 8% organic growth for the second quarter.

Q2 revenue of $642 million was up 1% overall and 3% organically, driven by 3% organic growth across all segments. We expanded second quarter gross margins by 20 basis points to 45.5%, primarily due to price, volume leverage and production efficiencies, partially offset by continued investments in engineering related to new product development. Q2 adjusted operating margin was 24.5%, an all-time quarterly high for IDEX and up 90 basis points compared with the adjusted prior-year period, mainly driven by our gross margin expansion and lower SG&A costs.

Q2 adjusted net income was $115 million, resulting in record high adjusted EPS of $1.50, up $0.10 or 7% over prior-year adjusted EPS. Our second quarter effective tax rate was 21.7%, same as prior year, but 80 basis points

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lower than our previously guided amount, primarily due to higher excess tax benefit from greater-than-expected stock option exercises in the quarter.

Free cash flow was solid at $118 million, up 8% over last year and 103% of adjusted net income. This was our highest Q2 free cash flow of all time. Finally, in regards to the balance sheet, gross and net debt leverage remained very healthy. A combination of our strong balance sheet, capacity on our revolver and free cash flow provides us the ability to deploy $2 billion in the next 12 months for the right M&A opportunities, while still maintaining our investment-grade rating.

I'll now turn to the segment discussion, I'm on slide 5, starting with Fluid & Metering. Q2 orders were down 2% overall and flat organically, mainly driven by the market-cautious sentiment we mentioned earlier, market contraction in the ag market and lower projects in energy. Q2 sales were up 1% overall and up 3% organically. All businesses, other than Banjo, grew organically in the quarter. Despite some market choppiness in North American distribution, FMT continues to perform well overall, driven by successful targeted growth initiatives in the industrial space, along with solid OEM demand, as well as our ability to capitalize on the favorable chemical market conditions.

Both our Viking and Richter businesses posted record sales for the second quarter in a row, driving strong growth in our pumps and valves businesses. The municipal water business remained steady and the oil and gas market conditions have stabilized a bit. As I mentioned before, the only business in the segment that contracted year-over-year was Banjo, which is impacted by the overall ag market dynamics. We're keeping a close eye on pre-season order patterns that generally occur in Q3 as an indicator to see if there's a chance for a rebound in 2020.

Finally, excluding restructuring expense, operating margin was 30.5%, up 100 basis points over the adjusted prior-year quarter, mainly due to price, volume leverage and productivity initiatives, partially offset by higher engineering investments.

Let's move on to Health & Science, turning to slide 6. Q2 orders were down 1% overall but flat organically, mainly driven by the market pressure in semicon and automotive. From a sales perspective, Q2 sales were up 2% overall and 3% organically, driven by our strong performance across all segments of our life science business as we continue to grow through targeted NPD efforts in collaboration with our key customers and leveraging strong secular growth trends. At Gast, we continue to see project wins with our NPD launch in the food and beverage space, driving double-digit revenue expansion.

In MPT, they have built a strong backlog driven by growth in the pharma market and we look for them to have a strong back half of the year. Finally, the unfavorable market conditions in semicon and auto negatively affected our Sealing platform and created headwinds to the overall sales and orders for this segment as sealing was down 18% in orders and 6% in sales organically for the quarter. From a margin perspective, excluding restructuring expenses, operating margin increased 100 basis points to 24.6%. This is primarily due to higher volume and lower amortization, partially offset by higher growth investments.

I'm now moving to our final segment Diversified. I am on slide 7. Q2 orders were down 3% overall and flat organically, driven by a tough comp in dispensing due to a larger project order in the prior year. They were down 22% in orders for the quarter. Q2 revenues were flat overall, but up 3% organically and I'll provide more color on that in a minute. Operating margin of 27.1% decreased 100 basis points in the quarter. This was driven by dispensing as they de-levered on their lower project volume. Sequentially the segment was up 130 basis points versus Q1. Our FSD segment's performance was mainly driven by solid results in our Fire & Safety businesses.

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On the Fire side, we continue to capture OEM demand and our cash products are performing well and the launch of our SAM product is getting a lot of attention in the market.

Within rescue, we are capitalizing on strong tool demand and seeing positive momentum around our NPD programs. Our eDRAULIC watertight tool that we launched at the beginning of the quarter is seeing high demand. At BAND-IT, its performance remained strong despite general softness in the auto market and lower industrial sales. However, we continue to win in the aerospace and several other niche verticals.

Dispensing story remains challenging. As I mentioned earlier, the business was down double-digits compared to prior year due to a tough comp against some large project wins last year. We expect the business to be marginally better in the second half but still down. They will continue to be a drag in the segment for the balance of the year.

I'll now pass it back to Andy to provide an update on our 2019 guidance.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Thanks, Bill. So, to wrap things up, let me summarize some additional details regarding our 2019 guidance for both the third quarter and the full year. I'm on the last slide, slide 8.

In Q3, we're projecting EPS to be in the range of $1.45 to $1.47, organic revenue growth of approximately 3% and op margin at about 24%. We're estimating a 1% top line headwind from FX assuming the June 30 rates, which translates into $0.01 impact of EPS. The Q3 effective tax rate should be about 22.5% and we expect to spend about $20 million in corporate costs.

If you look at the full year for 2019, again, we're raising the low end of our full year EPS guidance $0.08, our new guidance is $5.78 to $5.85. Full year organic revenue is projected to be 3% or 4% and op margin, again, about 24%. And the same with the next quarter, we expect the total FX impact at June 30 rates to be about 1%. The full year effective tax rate should be about 21.5%. We're expecting to spend about $60 million in CapEx. Free cash flow should be about 105% of net income. And corporate costs should be in the $78 million to $80 million range. As always, our earnings guidance excludes any associated costs of future acquisitions or restructuring.

With that, operator, let's turn it over to questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Deane Dray with RBC Capital Markets. Please proceed with your question.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning, everyone.

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

A

Hi, Deane.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Hey, maybe we should start with the macro since that seems to be where most of the uncertainty is. And Andy, we were with you last at EPG and you were clearly signaling at that time, you were seeing choppy daily orders and that seems to have come through in the results today. Couple of questions to start with, what was the cadence of the quarter? We've heard a lot of different commentary from the companies about the months and the quarter. So how did that progress in your view?

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

A

Yeah.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

And then some color on the distribution side, sell-in and sell-through?

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

A

Yeah. So, the overall cadence was different, Deane, than we've been experiencing here for the last year. I think in several conversations that I've had with people, I've noted that in the past year or maybe year-and-a-half, we've seen this cycle in quarter where you've had – have a weak month and maybe a slightly better month and then a relatively strong month. That's been the pattern here for quite some time. And the pattern was different. For the first time, we didn't see that ramp up in the last month of the quarter.

I will say that the early part of July is stable, right. So you're not seeing a decline of any kind, which I think is positive, but you didn't see that uptick in the last month of the quarter like we have seen in the past. And so, I think that really notes well to a decelerating environment, which is what we're experiencing certainly from last year first quarter to this year. So, frankly, no surprise. It's kind of what we've been expecting here for some time. And I think we've tried to do a good job of communicating that. And I think we're in the environment that we expected to be here coming into the year.

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Deane Dray
Analyst, RBC Capital Markets LLC

Q

And then view from the distributor, sell-in, sell-through?

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

A

Unlike a lot of folks, we don't have a lot of off-the-shelf distribution. We do have some, it's been fine. We don't see any major areas of stocking or destocking. I think that the biggest thing relative to folks is they're very cautious, whether it's in the distribution network or the OEMs, people are pretty cautious about anything with a big ticket. And I think we're going to see that until you get some certainty back into the marketplace.

The interesting thing about it is it doesn't feel like it's driven by, what I'll call, fundamental demand of under-capacity or overcapacity, which is typically what happens. This really feels manmade. And so the encouraging part of that is, if you get some resolution to some of these things, I think demand snaps back pretty quickly. I think the discouraging part of it is it doesn't really look like that's going to happen anytime in the near future.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Yeah. That's really helpful. And just to kind of extend the manmade observation, it's manmade and not execution.

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

A

Yeah.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

And that's pretty clear to us. And a just last question for me and this is – if there's ever a time to be asking this, it's now, your barometer of businesses. You always say BAND-IT, Warren Rupp and Gast.

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

A

Yeah.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

And BAND-IT, looks like it's holding up versus even with auto being weak and Gast had a good quarter. So take us through the barometers?

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

A

It's a mixed bag. What I would say is on the daily rate business, you definitely see softness. BAND-IT and Gast, in particular, have actually one nice chunks of business, but there are larger chunks of business that have been part of our targeted growth list. Warren Rupp is actually holding in. And so, if I look across the board, it's a mixed bag, all-in-all equaling deceleration.

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Deane Dray
Analyst, RBC Capital Markets LLC

Q

Terrific. Really good color. Thank you.

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

A

Thanks, Deane.

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

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Hi guys, good morning.

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

A

Good morning.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Can we go back to Health & Science orders? I think, Bill, you said the semi and auto part was putting pressure about, I think, it was down 18% in orders. Can you talk to maybe the life science and MPT, and some of what the order trends you're seeing on that side?

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

A

Yeah. So, life science is really solid and no concerns there. The MPT has a very good funnel of work that they work on. You know, Allison, as well as anyone, that that's pretty lumpy, but, generally, it's a good funnel of work they have there. The concerns are all around semiconductor and auto. The Sealing business, you said 18% down, that was the Sealing business in particular.

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

A

Yeah.

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

A

And that they have our largest chunk of semiconductor exposure. So, they're facing some headwinds there with semi and auto. And so, they're facing some headwinds there, but really good execution in most of the Sealing platforms, which is nice to see. So, I think those are just part of those cyclical markets, generally. Otherwise, very happy with the profit expansion that we saw in HST, that's a record for us. And I know this time last year, we had some questions about whether or not we were going to expand margins at the same kind of clip that we had in other parts of the company, and I think we've demonstrated that we can do that. And I think the life science stuff is in really good shape.

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Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Great. And then can we just touch on Velcora, so a little bit more color on there...

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

A

Yeah.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

...just in terms of growth rate, margin? Is it leveraged to any significant customers that we need to be mindful of?

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

A

Yeah. So, first of all, and this is a terrific business. We've known about this business for a long time. We cultivated the business ourselves. It's a wonderful business – I mean principally Roplan, which is the 85% of that business is a mechanical sealing business. A lot of exposure into faster-growing parts of the market, into life sciences, and just generally good positioning across the board. The business is profitable, it's an IDEX like business, and then we think with quite a bit upside frankly. It's a well-run company, a really terrific team of people. But we think, not unlike when we bought PPE back here quite some time ago, nine years ago now, that business – the margins, I think, more than doubled at PPE in that period of time, we probably won't do that but there is a lot of upside in terms of profit and growth rates.

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

A

And not heavily concentrated across a small group of customers.

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

A

Yeah. No. So, it's life science, food and beverage and then general industrial.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Great, thank you.

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

A

You bet, Allison.

Operator: Thank you. Our next question comes from the line of Michael Halloran with Robert W. Baird. Please proceed with your question.

Michael Halloran
Analyst, Robert W. Baird & Co., Inc.

Q

Hey, good morning everyone.

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

Good morning, Mike.

Michael Halloran
Analyst, Robert W. Baird & Co., Inc.
Q

So, just a quick tack on the debt. What's the accretion embedded in the guidance associated with the acquisition?

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

None as of now. And we're still working through final purchase accounting. We'll give guidance once we complete that come out of the third quarter, but nothing material, maybe $0.01 or $0.02 at most.

Michael Halloran
Analyst, Robert W. Baird & Co., Inc.
Q

Okay. So then on the acquisition M&A commentary, very strong robust pipeline, maybe you could talk a little bit about actionability, I know that's been a hurdle in the past.

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

Yeah.

Michael Halloran
Analyst, Robert W. Baird & Co., Inc.
Q

It sound a little bit more constructive, so ...

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

Yeah, so it's – look, as we've talked about here for quite some time, we've been working on a ton of stuff and have walked away from a lot of things. So, it's – the pipeline looks good, we've got a bunch of things that we're working on. Actionability, very hard to estimate, it's just – it's in this environment, we found time and again that you've had people who have been willing to pay kind of an exorbitant price at the end of a discussion. This is – Velcora was terrific because we were the only ones in there, had a very constructive long-term conversation going on and it wasn't an auction. The rest of the environment, frankly, is unchanged from when we talked about it 90 days ago, Mike.

Michael Halloran
Analyst, Robert W. Baird & Co., Inc.
Q

All right. Makes sense. And then just from a guidance perspective, understanding how you get to that 3% to 4% range [ph] and with the (00:24:37) orders 3-ish-percent plus or minus starting the year here. When you look to the back half of the year, is this about comps easing, where the time you hit the fourth quarter, that helps get to that range? Is it about the cadence that you're expecting from an end market perspective? Maybe just give some puts and takes and how you get to that 3% based on the environment today and then whether or not there's continued deceleration in the environment embedded in that assumption?

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

We're not – we don't have anything embedded in terms of further deceleration. We have not estimated that. It's basically at the levels that we're at today. We got to take it and straight line it, that's what it is. It's the fourth quarter that we have a much easier comp, right. Second and third quarters are tougher comps. Fourth quarter is a significant easier comp. There's no significant change, there's no major inflection that has to happen for us to get to these numbers.

Michael Halloran
Analyst, Robert W. Baird & Co., Inc.
Q

That makes sense. Appreciate it.

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

And seasonally, right, Q2 is a larger order and we decelerate a little bit, just because of seasonality in Q3. So to your point, flat orders on a larger number, yielding into Q3 is not straight math.

Michael Halloran
Analyst, Robert W. Baird & Co., Inc.
Q

Appreciate that, Bill. Thank you, guys.

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

Thank you.

Operator: Thank you. Our next question comes from the line of Nathan Jones with Stifel. Please proceed with your question.

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

Morning, everyone.

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

Morning.

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

Just maybe following on to Mike's question there and your answer to that, I mean it sounds like your – the back half of the year guidance embedded normal seasonality, not getting better, not getting worse, largely across the portfolio. Maybe you could talk about the things that could make it get worse, could make it get better, relative to what your current expectation is?

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

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Yeah, I wish I had a brilliant answer for you, Nathan. I think it's all the macro, frankly. We're going to work our body of product and customer opportunities and continue to push for our consistent 200 bps above market. I think it's all going to depend upon the global economy. I'm not sure that we're going to swing it one way or the other, meaningfully off our current trajectory, different than that.

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

Q

Fair enough. Maybe on margins, particularly FMT, in case anybody missed it, I think you crossed 30% margins there for the first time, so congrats on that.

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

A

We did.

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

Q

Is that the kind of level that you guys think you can maintain there? What businesses in that segment have the opportunity to improve margins a bit more? If we're starting to see slowing growth there, should we expect to see incrementals drop into that kind of 30% to 35% range? I think you expect when you're seeing lower growth here. And does that mean we should see margins flatten out here?

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

A

Yeah. So, I think, at the current volume levels that we're at, I'm not – I think we're about at the right level of profitability. On an increase in volume, you've still got headroom here because of the very high incrementals. The good part here is we have a – we don't have a huge mix of margin, we have some margin mix here, but we've got a lot of businesses that are now kind of pushing up against this higher 20s number. So, assuming that the world doesn't fall apart on us, that margin level feels pretty good.

At the same time, we've all got to be candid. This is a very high-contribution margin business. And if the business turns down, it's going to have a steep dropdown, that's just the way it is. We have contingency plans that we've talked about before on these calls, but and it's why we have been cautious in some degree about our market outlook. And so, my point of view is we're at a very healthy margin level now. We have further incrementals in FMT and in other parts of the business based on the high contribution margins and our ability to get price. And we are preparing, as we always do, if we have softening, to make sure we're appropriately resetting the business and taking out some cost in line with volume.

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

Q

You guys have always made it pretty clear that you have those kind of contingency plans for economic downturns. Are there businesses now where you actually need to enact some of those plans? Are there places where you need to take costs out currently with way the economy is?

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

A

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Oh, yeah. Definitely. If you look across the 40 businesses, if you look at folks who are more focused on auto, semi, ag, you absolutely have got to do that. And they've been doing that here since basically this time last year in one way or the other. Just from a process standpoint, number one, we're looking at this all the time. We go into any year having a contingency plan that's very, very specific. And I know I've said this in many venues before but just the high level math of this whole thing, our broader contingency plan is one that says, okay, with, what I'll call, vanilla recession, we think the top line is down 5 points plus or minus, right? And that 5 points is equal to about $125 million; unmitigated, that's going to be about $75 million in pre-tax profits. And we think that we can take out and not damage the business somewhere in that $20 million range pretty quickly.

A bunch of it's volume related, a bunch of it's services related, right sizing in certain places to have a larger overall impact. So you end up with a downside of, call it, somewhere between $50 million and $60 million. So, $0.50 to $0.60 a share and so what that's kind of 8% downside on a 5% top line downside. And that's the mentality that we've had. And, obviously, as you move into the businesses, the contingency plans look different than that. They are – and not everybody is the same, but that's our mindset. And so, as things decelerate here, I mean I'm not going to call a recession, but we're prepared if that happens and we'll pull the trigger on things and some things. Nathan, to your point, we are pulling the trigger on now, the small things that are being hit specifically with volume declines. Bill, anything you want to add there?

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

Yeah. No, I was just going to highlight, we did take a couple of restructuring actions in the quarter on those businesses that are seeing fundamental softness. So, we continue to evaluate and as businesses underperform, take action.

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

That's helpful color. Thanks a lot, guys.

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

You bet.

Operator: Thank you. Our next question comes from line of Matt Summerville with D. A. Davidson. Please proceed with your question.

Matt J. Summerville
Analyst, D. A. Davidson & Co.
Q

Thanks. Two questions. First, just on the quarter, where were you in terms of price realization year-over-year? And how did that compare to the inflationary pressure you're seeing in your businesses?

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

We continue to try and hit that a little over a point of price capture and at the high end of our historical price/cost spread, about 30 basis points to 40 basis points historically, a little on the higher end here in the second quarter.

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

A

Yeah. The team's done a super job with pricing and managing the spread. And to Bill's point, we are on that a little above our higher-end at 30 basis points to 40 basis points, which is good.

Matt J. Summerville
Analyst, D. A. Davidson & Co.

Q

And then, with respect to the HST overall, maybe to an earlier comment, Andy, at this point, do you feel like that business is breaking into a new sort of higher level of margin potential? And can you maybe talk about what areas you still can see sort of material improvement from here with the platforms that are currently in the HST portfolio?

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

A

Yes. So, I'm actually really, really proud of that team. We're at a record op margin there, with Sealing down 18%, with pretty high incremental margins in that business. So, when you set Sealing aside and you look at what the performance is of the rest of the business, it's pretty extraordinary. And actually, I'll give the Sealing team a lot of credit, managing that downside. They actually managed the cost structure really well, too. So, that's a good note.

So, I think we're in a good position. I'm liking it a little bit. If you went back to 2015, 2016, one of the things you guys couldn't see because the industrial businesses were getting kind of kicked around, is we were in the process of restructuring a number of businesses within FMT. And that breakout in profitability that we've had here in the last two, two-and-a-half years was about that, right. We have reset the margin structure of the business. And when volume came back, you've now seen what has happened to profitably at FMT. I don't think HST has that much upside. I'm not going to say that, but I think what you're seeing with us having a record with a key piece of the business being down and the fact that they are holding margin. When you see that pick back up, I think that bodes well for improvement in the overall HST margin structure in the future.

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

A

Yeah. We did do two plant consolidations within HST, too: one within MPT and one within the life science space. So, there were some structural actions, I think, to help us get it.

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

A

Yeah.

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

A

So, this point to Andy's comment, probably not huge increases going forward, more in relation to -

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

A

[ph] Commodity index (00:34:22).

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

Yeah, exactly.

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

One thing to note, though, Matt, and everyone should pay attention to this. Velcora is going to land into HST. They'll bring some amortization into there. The margins are a little bit lower than the HST average anyway. And so you will see some dilution in that as we go forward a little bit.

Matt J. Summerville
Analyst, D. A. Davidson & Co.
Q

Thank you, guys.

Operator: Thank you. Our next question comes from the line of Brett Linzey with Vertical Research Partners. Please proceed with your question.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Hey. Good morning, guys.

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

Good morning, Brett.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Hey. Just want to come back to incremental margins, and really thinking about the Q3 framework and the implicit in Q4. If you just look at incrementals at the midpoint, it does imply incremental that are just naturally above what those businesses typically do. Are you throttling back some investment spending or is it just some of that price cost benefit you're going to see here in the second half? Any color there.

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

We are not throttling back investment spending at all. You are going to see, we're going to hit that $60 million number for CapEx. As I've mentioned to you before, there are kind of 25 major programs or projects that myself, Bill, and Eric Ashleman and the rest of the team are really focusing on, and we are funding those. There are some places that are in cyclical downturns that we're pulling back, but in our places that we're betting, we're continuing to bet.

And one of the things that I'm really intent on and we're having – one of the reasons I'm so straightforward with you guys about what we're going to do if there's a downturn, it's the exact same conversation we're having with our board. Because if you get the scenario that I outlined before, what I don't want to do is go and take another $10 million or $20 million out, because with that you will throttle down investment. And if you have a recession that's 6 or 12 months, the last thing we want to do is let go a bunch of really critical people that you won't be able

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to hire back in this tight environment in the future, so I'm going to invest that $10 million or $20 million so we can continue to have better than market growth rates. So, we're keep it going and we're going to turn back on places that are weaker, but we're going to keep investing.

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

And I think our price capture helps enable that.

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

It does, yes. Absolutely.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Okay, good. And one then, I guess, just a follow-up to that, specific to just restructuring, you did a little less than $4 million in the first half, I think $12 million in 2018.

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

Yeah.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Do you expect to step that up in the second half of the year here?

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

Yeah. I think you'll see a few more things happen here that we've been teeing-up. But unless things materially weaken, I think it will be maybe a little bit higher, but it's not going to be a breakout number.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

Okay, good. And then just the last question, regarding the channel, maybe you could just compare and contrast what you're seeing in distribution versus direct in OE, specific to orders.

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

Yeah.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC
Q

How did that look in the quarter and then really into July here? Thanks.

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

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I'll have Bill comment on this some too, he's done a lot of work in this area. But there were two things that were different in the second quarter on the order front than in the first quarter. The first thing is that larger projects – and we've seen this pattern for the last eight years as I've been CEO, we see this pattern happen, when the softening kicks in, the larger scale stuff gets pushed out. I mean, you start to see that happen. And so that was one thing we have seen kind of larger projects get delayed.

And then secondarily, what we saw happen in throughout the quarter was the day rate businesses, some of these very short cycle businesses came down. And that's what kind of played out. The good news is, again, July has held up that you're not seeing a sequential decline anymore, which is a good thing. But you are seeing a little bit lower level and if you compare to the first quarter or the fourth quarter of last year in terms of the order book.

Brett Logan Linzey
Analyst, Vertical Research Partners LLC

Q

Okay. Good. I appreciate the color.

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

A

You bet.

Operator: Thank you. Our next question comes from the line of Andrew Buscaglia with Berenberg. Please proceed with your question.

Andrew Buscaglia
Analyst, Berenberg Capital Markets LLC

Q

Hi, guys.

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

A

Hello.

Andrew Buscaglia
Analyst, Berenberg Capital Markets LLC

Q

Can you talk a little bit about – so, you've made the comment that some of this is – the sluggishness is manmade, but headline suggests with semiconductors and auto and even ag...

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

A

Yeah.

Andrew Buscaglia
Analyst, Berenberg Capital Markets LLC

Q

... [indiscernible] (00:39:03) would say that could be a prolonged decline.

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

A

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Sure.

Andrew Buscaglia
Analyst, Berenberg Capital Markets LLC

Q

So, I guess, I'm trying to triangulate what you're seeing, maybe you're too niche to be impacted by that, but want to hear your comment on that.

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

A

Well, maybe one comment, the corollary we saw is in May, when there was a tweet around potential tariffs with Mexico, our industrial businesses saw immediate response in reduction in day rates. So, that corollary around this being not fundamental economics versus caution in the broader economy is somewhat of what we're basing that theory on.

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

A

Yeah. And also, Andrew, recognized that auto, semi, ag in total is 12% of the business, 10% of the business.

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

A

Yeah, we are less.

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

A

Yeah. So it's – you just got to recognize that that I'm referring to basically 90% of the business...

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

A

Yeah.

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

A

...that's not bad stuff. And so, as you look here, if you break down life sciences, you break down municipal, you break down general industrial, that's more of what I'm referencing. And look if we couldn't see that – as Bill described, if you couldn't see that corollary between those things and how fast that happens, it's really remarkable. And back to the question I got earlier about our canary businesses, we saw those in particular, I mean, please snap your finger and as you get good news, bad news, out of some of these trade and economic issues, we see it show up in our order book really quickly.

Andrew Buscaglia
Analyst, Berenberg Capital Markets LLC

Q

Okay. Okay. And then maybe just a more specific one within Health & Science Technologies, I know one of your larger customers, Illumina, had a weak quarter, did you guys look into that? Is there anything concerning there, given that they're kind of a barometer for what you do in biotech?

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

Yeah. So we're super careful about commenting on any customers. I think what I would say and this is a broader statement is our – sometimes people forget what we sell into these marketplaces and we're selling components that are going into instruments. And a lot of these businesses, you see some of their outsized impact positive or negative is really their reagents. And so the key to look at for us is our growth versus instrument sales. And what I can say very broadly throughout the marketplace is we track well and I would say take incremental share. And that's a broader statement than any one customer.

Andrew Buscaglia
Analyst, Berenberg Capital Markets LLC
Q

Okay. All right, thanks very much.

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

Thank you.

Operator: Thank you. Our next question comes from the line of Joe Giordano with Cowen and Company. Please proceed with your question.

Robert Jamieson
Analyst, Cowen & Co. LLC
Q

Hi, good morning. This is Robert in for Joe. I just wanted to go back to [indiscernible] (00:42:01) trajectory that we saw in Q2 is that's slowing down. Would now be the time to start to think about a possible – the possibility of orders starting to turn negative going forward? Could you provide any color on that?

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

I don't think so, Robert, the information that we have thus far wouldn't suggest that, but that being said, let's just – I mean, I think all of us are looking at this environment the same way, it is materially slowed sequentially. I think that the risk of recession has absolutely gone up, there's no doubt about that. But we have not seen any evidence of that as yet.

Robert Jamieson
Analyst, Cowen & Co. LLC
Q

Okay. Thank you.

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

Excellent.

Operator: Thank you. Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Mr. Silvernail for any final comments.

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Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Thanks, Mellissa. I appreciate that. Thank you all of you for joining us on the call today. Once again, I'm very proud of the work that the team has done in this pretty choppy environment. The levels of execution, and the levels of focus on the areas that matter most to us, and really building the culture of this company to continue to perform regardless of environment is what we have worked very hard to do. And so, I appreciate your time, and I look forward to talking to you again here throughout the quarter and then in the next 90 days. Take care.

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

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