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IDEX Corp. (IEX)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to IDEX Corporation's Second Quarter 2021 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.

It is now my pleasure to introduce your host, Michael Yates, Vice President and Chief Accounting Officer. Thank you. You may begin.

Michael J. Yates

Vice President & Chief Accounting Officer, IDEX Corp.

Thank you. 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 2021 financial highlights. Last night, we issued a press release outlining our company's financial and operating performance for the three months ending June 30, 2021. The press release, along with the presentation slides we use during today's webcast, can be accessed on our company's website at www.idexcorp.com. Joining me today is Eric Ashleman, our Chief Executive Officer; and Bill Grogan, our Chief Financial Officer.

The format for our call today is as follows. We will begin with Eric providing an overview of the state of IDEX's business, an update on our growth investments, and an overview of our order performance and outlook for our end market. Bill will then discuss our second quarter 2021 financial results and provide an update on our outlook

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for the third quarter and full-year 2021. Finally, Eric will conclude with updates on our sustainability and diversity, equity, and inclusion programs. Following our prepared remarks, we will open the call for your question.

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 number 13712090, or you may simply log on to our company's homepage for a webcast replay.

Before we begin, a brief reminder. This 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 this call over to our CEO, Eric Ashleman.

Eric D. Ashleman

President, Chief Executive Officer & Director, IDEX Corp.

Thank you, Mike. Beginning with our overview on slide 6, the past year-and-a-half have been among the most dynamic and unpredictable ever experienced, but our IDEX team stepped up again in Q2 and delivered during an extremely challenging environment. Thank you to the IDEX employees around the world who are working so hard.

Our commercial performance is very strong as we recorded record orders and backlog in the quarter. Order trends continued to improve sequentially and all three segments are materially above pre-pandemic level. Our day rates are very strong and our OEM order patterns are robust. Only large industrial projects, many of them in FMT, continue to lag a bit. We're beginning to see the move into planning funnels, indicating support for continued phases of organic growth in the back half of 2021 and next year.

Our number one operating challenge for the quarter was supply chain and logistics disruptions. IDEX is generally a short-cycle business with quick lead times. We typically operate at the component level, further down our customers' bill of materials. We're also not very vertically integrated. We depend on a tight network of supplier partners, often located close by our operating units to quick-turn our solutions with a minimum of visibility.

For these reasons, the challenging conditions of tight material supply and bottleneck logistics tend to lag other industrial companies. Our agile model does support a quick calibration to today's realities and it helps us exit quicker than many on the backside of the supply side constraint.

Overall, we believe these disruptions have hit a plateau. We don't see things getting worse and the challenges will continue to be highly variable. At the same time, we don't anticipate these disruptions getting better soon. And most likely, they will not subside until the end of this year or early next year.

We anticipated rising inflation as the global economy recovered, but like many, did not imagine the sharp rate of increase. This narrowed our spread between price capture and material costs, although we remain positive overall. Our teams leveraged the systematic investments we made a few years ago in pricing management and aggressively deployed two, sometimes three pricing adjustments with precision. We are on track to expand our price/cost spread to typical levels as we travel to the back half of the year.

While we spent a lot of time talking about our businesses' ability to capture price, one area I don't want to miss is our continued focus on operational productivity. Our teams continue to drive margin improvement through 80/20 simplification, lean effort, and through sound CapEx deployment. Our robust project funnels continue to be

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another weapon to combat rising costs. The one project that exemplifies this spirit deserves mention as we discuss Q2.

Our energy market, now starting to show some signs of recovery off the bottom, are still lagging the overall group. Our teams are aggressively executing a facility rationalization project to consolidate our scale and focus our human resources to close working proximity. Ultimately, this is a long-term value driver for that group. But in the quarter, the project created headwinds for us as equipment was delayed and inventory positions were less than ideal to support production transports.

We expect the project to be back on track and completed by the end of the third quarter. Overall, I am confident in our path through these choppy recovery [ph] seas, we (00:05:29) continue to apply relentless focus from outstanding teams to deliver solutions that matter from high-quality businesses that are very well-positioned within their application steps.

Moving on to slide 7, we deployed just over $575 million in the first half of the year with our acquisitions of ABEL Pumps, Airtech and a small investment in a digitalization technology start-up within the fire and rescue space. We continue to build out processes and capabilities to explore additional strategic investments we want to make across IDEX. Our funnel for potential acquisitions is stronger than it has been in the past, and we are more aggressive in pursuing opportunities that enhance our business solutions, fit well with our style of competition, and drive IDEX-like returns. It's early days in our integration of ABEL and Airtech, but we're happy to see that each business is performing well with excellent growth prospects in the near and long term.

While we've stepped up our M&A game, we're also investing on our existing business with a 45% increase in capital spending through the first half of the year. We're in the process of expanding IDEX facilities in China and India. We project significant ongoing growth opportunities across Asia, and these investments are critical to support our local-for-local approach as we move to the next level of competitive advantage. We're also focused on our digital strategy with our largest investments tied to our areas of higher integration and scale as we seek to drive higher impact for our customers.

Lastly, as I mentioned previously, we're focused on operational productivity as market dynamics are changing, as well as investing in new technology to support growth. This is on both the CapEx and OpEx side. Some of these investments are targeted at new applications in high-growth areas like components to enable new global broadband satellite networks, building batteries for electric vehicles, and providing key products to support the build-out of incremental capacity and semiconductor manufacturing. These investments are combined with targeted spend in areas to support automation and efficiencies across the shop floor. This strategic approach to both inorganic and organic investment is already paying off and sets us up for ongoing success for years to come.

Turning to our commercial results on slide 8; as I mentioned, order strength continued in the second quarter, both compared to prior year and sequentially, resulting in a backlog build of $65 million in the quarter. As we look across our segments, all rebounded well from the pandemic and delivered strong organic order growth. Sequentially, Fluid & Metering Technologies and Fire & Safety/Diversified Products saw increased orders compared to the first quarter. Our Health & Science Technologies segment also saw increased sequential orders if we exclude the impact of a COVID testing application de-booking that occurred in Q2.

Order intake across all segments was also above second quarter 2019 levels. FMT lags HST and FSD due to lower levels of investment in the oil and gas market, as well as the concentration in the industrial market which saw a pre-COVID pullback in the second half of 2019. These commercial results give us confidence in our ability

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to deliver double-digit growth in the second half of the year and continue to highlight the resilience of our businesses and the criticality of our solutions to customers.

On slide 9, we provide a deeper look into our primary end market. Our focus is shifting from recovery to growth as most of our businesses are now performing above pre-pandemic levels. Even with pockets of concern around supply chain disruptions and COVID in certain geographies, we're optimistic about the outlook of our end markets and our ability to execute within them.

In our Fluid & Metering Technologies segment, industrial day rates were strong. Supply chain challenges remain, but overall the market trajectory was at or above 2019 levels with only large projects lagging as I mentioned earlier.

Agriculture continued to drive strong growth driven by aging farm equipment and record crop prices. Our water business was stable. We continue to monitor the impact of the federal infrastructure package and US municipal spending. Energy and chemical markets continue to trail 2019 levels, primarily due to limited capital investment in the sector, as well as a longer project close cycle.

One item to highlight for FMT is the impact of our FMD acquisition last year. It's now in our organic figures. And with its backlog burn last year and significant pullback in customers' capital investments, it impacted FMT's organic sales by 11%. In other words, FMT's organic sales for the quarter would have been 19% instead of 8%.

Moving to the Health & Science Technologies segment, we're seeing recovery [ph] in activity (00:10:15) growth across all our end markets. Semicon and food and pharma continue to perform well, driven by strong market demand and winning share into our targeted growth initiatives. The overall automotive market continue to face supply chain-driven challenges, but we outperform the market due to our product concentration and higher end European vehicles. Our AI and life science market continue to perform well as the pandemic impact eased and investments have increased. The industrial business within the segment saw a similar result to FMT.

Finally, in our Fire & Safety/Diversified Products segment, dispensing rebounded as large retailers freed up capital and worked through pent-up demand for equipment. Our Band-IT business was adversely affected by US automotive production pullbacks due to microprocessor shortages in the second quarter. However, we continue to achieve new platform wins and believe we're well-positioned to outperform the market as supply chain constraints ease.

In and fire and rescue, we have yet to see larger tenders come back, and emerging markets remain slow. We continue to closely monitor market conditions and expect some choppiness in the second half of the year. That said, we're confident in the future trajectory of our end markets, as well as our ability to execute on our strong backlog and have raised our organic growth expectation for the year.

With that, I would like to turn it over to Bill to discuss our financial result.

William K. Grogan

Senior Vice President & Chief Financial Officer, IDEX Corp.

Thanks, Eric. I will start with our consolidated financial results on slide 11. Q2 orders of $751 million were up 44% overall and 39% organically as we built $65 million of backlog in the quarter. Organic orders grew sequentially and year-over-year in each of our segments, as highlighted by Eric on the prior slide.

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Second quarter sales of $686 million were up 22% overall and 17% organically. While we experienced a strong rebound from the pandemic across our portfolio, we were impacted by the supply chain constraints at our energy site consolidation, which tempered our results. And the FMD pressure in fluid metering Eric discussed also had an impact on our overall organic sales. Excluding FMD, organic sales would have been up 22%.

Q2 gross margin expanded by 280 basis points to 44.6%. The year-over-year increase was primarily driven by increased volume and price capture, partly offset by inflation and supply chain impacts. Excluding the impact of $1.8 million pre-tax fair value inventory step-up charge related to the ABEL acquisition, adjusted gross margin was 44.9% and was approximately flat sequentially.

Second quarter operating margin was 23.1%, up 340 basis points compared to prior year. Adjusted operating margin was 24.4%, up 330 basis points compared to prior year, largely driven by gross margin expansion and fixed cost leverage, offset by a rebound in discretionary spending and investment. I will discuss the drivers of operating income in more detail on the next slide.

Our Q2 effective tax rate was 21.3%, which was lower than the prior-year ETR of 22.7% due to benefits from foreign-sourced income in the second quarter of 2021. This benefit also drove favorability to our guided rate for the quarter. Q2 adjusted net income was $123 million, resulting in adjusted EPS of $1.61, up $0.51 or 46% over prior-year adjusted EPS.

Finally, free cash flow for the quarter was $120 million, down 25% compared to prior year and was 98% of adjusted net income. This result was impacted by a volume-driven working capital build, higher CapEx and timing of tax payments, partially offset by higher earnings. Our working capital efficiency metrics remain strong. The teams continue to do a good job managing the significant volume changes year-over-year.

Moving on to slide 12, which details the drivers of our adjusted operating income. Adjusted operating income increased $49 million for the quarter compared to prior year. Our 17% organic growth contributed approximately $41 million flowing through at our prior-year gross margin rate. We maintain positive price material cost within the quarter and leveraged well on the volume increase. Our high contribution margins helped mitigate the private headwinds we experienced from the supply chain disruptions.

In the second quarter of 2020, discretionary spending and investment were minimal, driven by a strict cost control environment during the pandemic. As we return to a spend level in line with our growth and continued strategic investments, we see year-over-year pressure of about $11 million, in line with the guidance we gave at the beginning of the year. Even with the incremental spend, supply chain and operational issues that tampered our performance, we still achieved a robust 45% organic flow-through. Flow-through is then negatively impacted by the dilutive impact of acquisitions and FX, getting us to our reported flow-through of 39%. As we highlighted, we expect to reinvest aggressively in the business to drive both organic and inorganic opportunities. We expect that our level of discretionary spending, as well as associated costs from growth initiatives, will similarly reduce organic flow-through in subsequent quarters.

With that, I would like to provide an update on our outlook for the third quarter and full year. Moving on to slide 13. For the third quarter, we are projecting EPS to range from $1.57 to $1.61, we expect organic revenue growth of 14% to 16%, and operating margins of approximately 24.5%. The third quarter effective tax rate is expected to be 23%, and we expect a 1% top line benefit from the impact of FX. And corporate costs in the third quarter are expected to be around $21 million.

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Turning to the full year. We are increasing our full-year EPS guidance from our previous range of $6.05 to $6.20 up to $6.26 to $6.36. This range includes Airtech, which will contribute $0.06 in the second half of 2021, roughly $0.03 a quarter. We are also increasing our full-year organic revenue growth from 9% to 10% up to 11% to 12%. We expect operating margins of approximately 24.5%. We expect FX to provide a 2% benefit to top line results. The full year effective tax rate is expected to be around 23%. Capital expenditures are anticipated to be around $65 million, an increase of around $10 million versus our last call as we increase our investments in growth opportunities.

Free cash flow is expected to be 110% to 115% of net income, lower versus our last guide primarily due to additional capital spending and higher working capital support or increased volume. And corporate costs are expected to be approximately $77 million for the year. Finally, earnings guidance excludes any costs, earnings associated with future acquisitions or restructuring charges.

With that, I'll throw back to Eric for some final thoughts.

Eric D. Ashleman

President, Chief Executive Officer & Director, IDEX Corp.

Thanks, Bill. I'm on the final slide, slide 14. Before we open the call up to questions, I'd like to share an update on our ESG journey and the evolution of our company culture. I pledged earlier this year that we would hire a new Chief Diversity, Equity and Inclusion Officer. I'm pleased to announce that I now have Troy McIntosh in my senior leadership team. He joined us just last week from UScellular, the fourth largest cellular communications carrier in the United States, where he led significant improvements in their culture and levels of diversity in the workforce.

At IDEX, Troy will help build the global road map and success measures for DE&I. He will help embed DE&I deeper in our culture and build inclusive leadership, confidence and capabilities in all our people through training, education, and coaching. He will help us make sure our systems mitigate bias and create opportunities for everyone, no matter their background, to reach their full potential at IDEX. I look forward to great things happening with his leadership.

I'd also like to share a nice step we're taking to improve our energy efficiencies. Work recently began on a solar array on the roof of our LUKAS manufacturing facility in Germany. Once completed next month, this collection of solar panels will be about one-third the size of a European soccer field and provide 30% of the electricity needs for the facility. Not only will it help reduce our carbon footprint there, we estimate it will save the business more than €67,000 in just the first year alone. We anticipate this project will serve as a pilot leading the way for other solar installations on IDEX facilities around the world.

Lastly, I want to share that the catastrophic flooding that devastated portions of Western Europe earlier this month has impacted many IDEX employees. About a quarter of the employees at our German Fire & Safety business, Vetter, have either had their homes severely damaged or destroyed. All of our employees are safe living with friends and family as the recovery efforts are ongoing; and operations continued at our Vetter facility, which is not directly impacted by the flood.

Amid all this destruction and loss, we once again saw the spirit of IDEX come through. The colleagues from other IDEX businesses in Germany came to the area to assist. With pumping equipment from our businesses, our people worked tirelessly to help draw water from flooded homes to the long road to recovery will begin. The IDEX Foundation also donated $100,000 to the German Red Cross, which has thousands of people in the region assisting those impacted.

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While I shared this internally, I want to again express with our employees at Vetter that we stand by you through this terrible tragedy, and thank you to all the dedicated and selfless IDEX colleagues who dropped everything and volunteered during this time of need. You're outstanding examples of what makes this company so special.

With that, let me pause and turn it over to the operator for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, at this time, we will 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.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Good morning, Deane.

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

A

Hi, Deane.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Hey, maybe we can start with Eric's early comments in the prepared remarks. And I know you touched so many end markets within the diverse product line. But what are the indicators you're looking at that suggests that the supply chain disruptions have peaked to kind of your degree of confidence? And the reason that I'm also asking is, like we heard yesterday from GE and 3M, and neither of them sounded as confident, that the worst had passed, but you're sounding a bit or noticeably more optimistic here. So, maybe we can start there. Thanks.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Well, sure, Deane. Yeah. I guess all of this is somewhat relative at this point. I mean, make no mistake, this is really, really tough right now. And so getting a steady state of tough is what it is. I don't want to mischaracterize it there. For us, a couple of things to remember. We're a little less exposed to a lot of the electronics microprocessors things than other businesses are. Our bill of material is generally a little bit more streamlined and simplified. We don't have as many aggregations to complex systems. We do a lot of great critical components. And we still – we have a lot of suppliers that are pretty close by that honestly we drive by on the way to work.

That being said, it's still very difficult for us. The indicators we're looking at, things like lead times, what are the quota of lead times and then what is the performance against them. And, look, they have lengthened and extended, but they're generally kind of holding at this point. And the delivery rates against them, while not great, are, at least in our world, pretty stable at this point. So, I just want to emphasize the relative nature of the

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comments and say, for us, it's very, very tough environment, but we see it the one we can now begin to plan around given what we do.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's real helpful. And if we can state like more of a real-time analysis here if we could, commentary about your day rates would be helpful. And the mix, still not seeing kind of larger projects yet, but maybe there's some front log discussions that you could share. And any commentary about how July has started. Thanks.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Sure. Sure. So, if we kind of go back to the end of 2020, most of the acceleration that we're seeing was in that restoration of industrial day rates in our businesses. And as we look at the second quarter and even into the first days of July, it's pretty stable at this point. I mean, it's kind of at a healthy clip. We'll see it move on in terms of price and some things that come up. But it's not accelerating at the same rate nor is it, in our world, decelerating. Think of it as stable. And then there's two other components that we think a lot about for a ton of IDEX businesses.

And they're in the project category, but they're different degrees in terms of size and scope. So, what we are seeing and what's contributing to growth and I know will continue into Q3 and Q4 are what we would call lots of small projects. These are discrete things where people are optimizing the system instead of asking for 1 or 2 if something is 10 to 20. And they're running their factory or their production lines, but they're trying to optimize it, enhance throughput, get productivity. Those are the kind of things you can do on the run. And so we're seeing that those are the strong contributors, and we think they'll continue.

Right past it are the classic larger projects that we and others play with. A lot of them in kind of the chemical, oil and gas, infrastructure spaces. And there's just a general story there still where those things are delayed. They were frozen in 2020. They were pushed out into 2021, not cancel. I will say what we're starting to hear now, and mainly from distributors that are a little closer to the front lines, are that those are now starting to turn into quote activity and spec transfer, and the kind of things you start to see ahead of an order and a replenishment cycle on our side. When does that happen? Maybe there's some of it in the back half of the year. Certainly at a minimum, we start talking about it more in planning, and I think it bodes well for the early part of 2022.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Great. That was exactly the color we were looking for. Thank you.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

You bet.

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

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

Q

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Hey. Good morning, everyone. I mean, just an update on how you're thinking about the M&A environment, your pipeline, and how you're thinking about actionability of that pipeline today. I know you've got a fair amount of capacity still sitting in front of you. And I'm just curious how actionably you think that is in the short to medium term here.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Sure. Sure. Well, I mean, I kind of view it upside down maybe. The availability side is really, really good. I mean, we could go through the specific numbers, but we've got plenty of availability and firepower to spend. On the inside, we've been talking now for a couple of quarters about the intentionality of the resource bill and the time and effort we're taking to consider all of the areas where we'd like to do more business. Some of it through inorganic efforts.

Think of this as a series of concentric circles radiating around places where we participate today and participate. And a few things., we're actually thinking of some zones where we're not part – not currently part of IDEX. It could be interesting or have IDEX-like attribute. So, we've got the firepower, we're doing more work. And then the funnel of things that we're looking at, it's very active, aggressive; and I think, in the end, actionable.

Now, we still are going to take the same discipline that we've had to any of the things that we're looking at. It's got to meet certain requirements, got to fit into IDEX, got to leverage what we do best. But I'll tell you that we're looking at more things than we have before and probably more areas than we have previously with more people involved and lots of firepower to get the work done.

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

Q

So, on that point, there are more areas than maybe you've previously looked. I'm guessing it's not really a change in the strategy [ph] nor (00:26:58) maybe just more iterative in broadening. Maybe some high-level thoughts on what that changes and areas that you might be thinking of loosely.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Yeah. I like this analogy, and I used it a second ago. I really think about it as radiating concentric circles. So, there's an anchor position generally and work that we're doing today, whether it's in the fluidic space, some of the stuff in life sciences. But I think we're willing to extend outward a little bit in terms of what's the solution that we would bring to our customer set. And so that's maybe the area of difference or slight tweak to the model.

With OEs, I mean, we've mentioned an open aperture for at least a couple of years now. At least, an open mind to some things that might be very interesting that we've long considered for IDEX. I don't know if that's different. That's always been on the page. But these would be the two areas that – there's a separate resource base thinking about a little further out from what we've done before, but still anchored to how we do it, and a couple of zones that have always been interesting to us because they have IDEX-like attribute.

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

Q

Well, it makes sense. And it's part of your question with Deane, you talked about some of these businesses feeling better about those as they've tracked towards 2022. Maybe just high level, how are you thinking broadly

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about all the puts and takes you're seeing in the portfolio now, and what that means once you hit a more normalized run rate, orders, record levels?

You're seeing some normalization in margin, or at least with pressures from a price/cost perspective can look like as you move through the year, the timing as some of these later-cycle things start getting a little bit better as you move through this year or maybe late – early next year, you can start seeing a little bit more CapEx. Just how does that all kind of come together when you're thinking about that one- to two-year outlook just from your seat? And what do you think the constraints are on top of that?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Yeah. Sure. So, I think it's a good question, and I like the way you phrased it. If you start from the highest level and think about the next couple of years, I think you'll start with a very positive perspective. You recognize that, look, we're now coming through a pretty acute recovery cycle that hasn't completely played out. Then there's a replenishment cycle that not only, I think, is reflective of the time that we sort of were all locked away. But I think even ahead of that, there was a decent amount of industrial capacity that needs to be put back into the system.

The real question, I think, as we go is, if you think of this as a series of graph lines with very sharp peaks and troughs – and this is super dynamic in terms of the elements we're dealing with today – as they smooth out and look a little bit more like the Appalachia, I think that that becomes a little more of a standard operating environment with positive momentum. And so many of the dynamics that we're talking about now in terms of when they come back or when they reoccur, I think they would be in place and they would be things that would be typically useful looking at. And it would feel a little bit normalized in terms of the way that we would operate with favorable wins at our back in all of the places that we play.

So, I think – we view it that way. We're planning for it that way. But it's a positive outlook, a positive framework. You just sort of have to navigate some of the puts and takes, and there's a lot of dynamic variables there; none of which, I think, really get in the way of that positive outlook.

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

A

And I think the economics...

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

Q

Thanks.

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

A

...associated with that growth would very much look like our traditional profile that we'll lever extremely well. Some of the facility consolidations that we're executing on this year will be foundational, some of that margin improvement.

And then, two, just as we've proven here, we've progressed through the year. The team's ability to go out and capture incremental price to deal with some of the supply chain issues and rising inflation will be bedrock as we go forward if that inflationary environment continues on for a couple more quarters.

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

Q

Appreciate it, gentlemen. Thank you.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Thanks, Mike.

Operator: 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. I just...

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Hi, Allison.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

...want to turn to the incrementals. I know, Bill, you had mentioned, from a corporate perspective, that discretionary and reinvestment were going to step-up a bit here, which makes sense. But are there any notable change that we kind of think across the segments? And I know each segment has done specific challenges that might be altered sort of in the near term as we think about the back half.

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

A

No. I mean, I think outside of FMT – and there's two things I think we highlighted. We're in the quarter one. Some of the challenges we have with our facility consolidation is energy. And then just a year-over-year comp for FMD and the pressure that that's putting on FMT's margin, last year, they ran record backlog levels and had some really large projects of the second and third quarter. That will weigh more on FMT's margins year-over-year. But outside of that, the other two segments should perform pretty consistently with how they've done in the first half of the year.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Got it. And then just want to just confirm I hear in the [indiscernible] (00:31:59), you said it was a little bit compressed near term, which makes sense. Do we assume that we exit 2021 with, I would say, what is a more normalized spread for you guys there?

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

A

Yeah. Exactly.

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Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Yes.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Perfect. Thank you.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Thanks, Allison.

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

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

Q

Good morning, everyone.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Hi, Nathan.

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

Q

I want to just follow up on Flow MD, obviously had a pretty big impact in the quarter. Can you maybe just give us a little bit more color on recent order trends, recent backlog trends there, when you think that will switch from being a drag to being a tailwind as that business returns to some growth?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Sure. I mean, it's like a success story for that business. They had – they were burning backlog nicely; started right at the point of acquisition. Then, of course, COVID came along and devastated a lot of the core markets there. And it's a little bit more project-intensive than the average IDEX business, just by the nature of what they do.

These are large units that they're going out there in custody transfer in large pipeline projects and things like that. And then if you think of that environment, I mean, there's been a couple of very sort of public shocks in that particular area as well where it just – right now, the spend is very [ph] intentional (00:33:20) toward some other things, simple maintenance, and those kind of items. So, I think it's going to be a little while before that breaks.

That said, the international markets are a little different than what we're seeing here in North America. They're generally more favorable. That business has been pointed towards those strategically long before we bought them, and they continue that way. So, we think definitely that's a nice extension for it.

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But I think as we saw, even with the events that happened here a little bit recently, it didn't take too many days for things to be off-line before our economy felt it. And this business makes the move incredibly great, a nice piece of the technology that are very useful in that continuum. So, we like it from the long term in what it does. We think the prospects long term are positive in nature. But I think it's going to take a while for this trend here because of the nature of it and where it's happening to break free.

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

Q

So, on a sequential basis, do we at least kind of hit the bottom or is there still more down here in your opinion?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

No. I think the bottom is a fair characterization.

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

Q

Okay. And then, I just want to follow up on the digital investment that you made in fire and rescue. Any color you can give us around what that is, what the future digital investments look like for IDEX, and how you expect that to impact a variety of your businesses?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Yeah. Yes. I mean, look, it's really small, but from time to time I think that's the nature of what some of these things would be. I will tell you, it extends some of the things we've been working on anyways and talking about. I think for a while now, we've talked about some great work that we're doing to automate how that job happened. So, replacing a sea of levers and gauges and pulleys with a touchscreen. And we've got some outstanding products that we sell to automate that now.

This small extension allows you to take some of that data off the truck essentially, make it more affordable and available to be used in other areas for firefighters. So, I think it's a good example of this kind of things we probably see from time to time from IDEX, whether there's some job that we're doing and there's a way to enhance it and make it a lot more valuable. And sometimes, it actually comes in very small middle transactions like this one. And so it's an indicator of things to come and levers nice scale that we have in fire and rescue and a lot of things we've been working on for a number of years.

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

Q

Is this kind of technology transferable to other parts of the portfolio or is this really a discrete kind of thing?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

It could be. We didn't select it for that reason. You never say never. There's things here that you can imagine what happened in other places. We'd be careful given the small size of it and just – we're kind of an 80-20 organization anyway, so let's focus on the job we need to do at hand. But I wouldn't rule it out entirely.

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

Q

Great. Thanks for taking my questions.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Thanks, Nathan.

Operator: Our next question comes from the line of Scott Graham with Rosenblatt Securities. Please proceed with your question.

Scott Graham
Analyst, Rosenblatt Securities, Inc.

Q

Hey. Good morning, Eric, Bill, Mike.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Good morning, Scott.

Scott Graham
Analyst, Rosenblatt Securities, Inc.

Q

A couple of questions maybe around price/cost. I've heard all of the commentary. Would you be able to tell us what price/cost actually was in the quarters? What that gap was?

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

A

Yeah. I mean, we said our historical price/cost spread is somewhere around 20 or excuse me 30 to 40 basis points, and we can press a little bit under 20 within the quarter. And, again, the pricing actions that we've taken when we look to be back at that normal level here as we progress through the back half of the year.

Scott Graham
Analyst, Rosenblatt Securities, Inc.

Q

Got it. Thank you. Yeah. The other thing I was going to ask is certainly around the project because some of these things obviously can be very lucrative to you because they are – and the customer chooses you to do something [ph] to realize (00:37:17) pricing power in there.

I was just wondering kind of like, are you – do you think that based on what you're seeing out there, some of this quoting activity that you're hearing about through distribution, is this a conversion into, let's say, the early part of next year? I mean, you guys have a lot of experience on this stuff. So, in this sort of funky cycle that we're in, when do you start to see – when would you normally start to see that? Is that early next year you'll have potential?

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

A

I mean, like, it varies to some degree, but I would say the median of that distribution would say, if you're talking about it now and at the distributor level, there's things that we would have to do to be involved in terms of

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specifications, and then there's standard lead times. We're usually not the longest one anyway, [ph] it's through the (00:38:12) other parts that would go into a project.

So, if I had to say where's the median zone, it's probably in the beginning of 2022 where a lot of it would actually be put in place, things of that nature. But some could be sooner, some could be later. It, again, depends. This is a wide spectrum given the nature of IDEX. But probably the sweet spot, I would say, you talk about it now through the back half, you plan it, you maybe get it booked, and you'd see some of it run out into the beginning part of next year.

Scott Graham
Analyst, Rosenblatt Securities, Inc.
Q

Got it. Got it. And last question. Same for you, Eric. So, you talked around why the organic was maybe a little bit below the guide. Is essentially what you're saying here is that those delays moved from 2Q to 3Q, which is maybe why 3Q is sort of like an outsized organic?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.
A

Well, I mean, that – look, anything that was constrained on our side, of course, is – and people still want it, it's going to move into the next place. I mean, for – because we're ultimately thinking about not just us, but everybody, is how you go to that next level of output and throughput and capacity. And, of course, as you know, we're kind of low on the food chain in a lot of places, so it's only as good as everybody being able to make a move up at this point.

So, I think right now, where we are is a lot of things have kind of stabilized around this reality. Everybody's working on it, us included. We're coming up in the fall maybe labor availability for people that are more labor-intensive. That gets better. I think that's the kind of ramp that you would start to see. It's less a complex math problem and more just ultimately people working like crazy to figure out a way to get to a place where you can process more of the backlog that many of us have.

Scott Graham
Analyst, Rosenblatt Securities, Inc.
Q

Understood. And I promise, this is my last question. This is the time of the year where your predecessors started to talk about a sort of a construct around 2022 sales. That was kind of what my earlier question was starting to get to. Is there anything you could offer on 2022 at this point, Eric?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.
A

I would not want to do that. Maybe this would normally be the time but, I mean, there's a lot of variables still out there, including one we haven't talked about yet here today, which is where does the nature of our virus go and things of that sort. So, I just – it would be too speculative and wouldn't really, I think, imply a lot.

I think, look, we generally feel, as I said before, that we think that the strong winds at our back are going to continue. We know that we and others are working to elevate capacity of throughput, which is going to be beneficial to all of us. And there's just a function out there that eventually variables have a tendency to smooth over time and they become expectations, and we see all of those things leading up for more positive days ahead.

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Scott Graham
Analyst, Rosenblatt Securities, Inc.

Q

Thanks a lot.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Thanks, Scott.

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

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

Q

Thanks. Couple of questions. Pricings come up a couple times here in the Q&A, and I was just wondering, Bill, if you could provide in absolute terms what your price realization was through the first six months of the year and how much incremental price capture you're looking for to get back into that 30, 40 basis point spread that you typically aim to be in, please.

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

A

No. I mean, we were close to a little over a point in the first half, and we're going to accelerate from that in the back half would be kind of the framework I'd give you.

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

Q

And then given your answer to an earlier question, Eric, a steady state of tough or bad or whatever sort of word you used. I'm talking about supply chain. Is that resulting, I would imagine, in similar anxiety among your customer base with you being a supplier to them? In that sense, do you get the sense that they're pulling forward demand, they're over-ordering. Can you talk about what you're seeing in terms of sell-in and sell-through into your distribution channels, please?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Yeah. So, I would say like we've had this question now for a couple of quarters. And generally, as you know, we do a lot of customized products, a lot of things that are very, very hyper-specific and have a lot of like just high-volume stocking orders and things like – or part. So, we're not a great company to stock a lot of materials.

That being said, I probably would point to – this quarter is a higher number of that. We're just because of – I mean, our own lead times are extending, and that's an unusual occurrence. We're aggressively doing some things on price, us and everybody else. So, there's – I don't think it's a giant number for this – for IDEX. It's just kind of campy. But it's in there more than we've seen before in terms of people trying to get a place in line or potentially say, hey, can I – I'll take a risk here so I can avoid part of the price increase.

But it's – I mean there's a point or two at the company. It's not a giant cart, only applies into – distribution, well, you go to a lot of our distributors, you're not going to see a lot of product on the shelves mainly because of just the model. It often needs to be customized at the last minute [ph] just on regard (00:43:29). We have quick lead times

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anyway. That doesn't add a lot of value to sit on a shelf somewhere and make that guess. So, I guess long story short, we have probably a higher incidence of this than we typically do. But because of the nature of IDEX, it's still a really, really low number for us.

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

Q

Got it. Thank you, guys.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Thanks.

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

A

Thanks, Matt.

Operator: Our next question comes from the line of Rob Wertheimer with Melius Research. Please proceed with your question.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thanks. Good morning, everyone.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Hi, Rob.

Rob Wertheimer
Analyst, Melius Research LLC

Q

So, I was thinking of the comments you made in the prepared remark on CapEx, spending opportunities, advanced manufacturing; and I wondered if you could expand on them really in whatever direction you like. But I was curious about ROI versus inorganic investment right now, maybe specific margin improvement on projects that you're doing related to that. Maybe how far down the road you are [indiscernible] (00:44:23) for a long time, or if there's a real shift here in what it could mean for a margin potential over time? Just love to hear more about it.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

All right. So, like, we don't have a lot of CapEx intensity at IDEX anyway, but it is a ramp-up from where we've typically been. A lot of it is attributed to the story around emerging markets for us. So, we're taking very deliberate actions in both our areas of concentration in China and India to make long-term infrastructure [ph] bets (00:44:52) over there to support a really, really, really good local-for-local capability set that we have. So, there's the big driver there that, of course, doesn't reoccur all that often.

Outside of that, it's a next level down in the category of doing it more than we used to would be things like factory for automation. The technology that's available is pretty phenomenal today. And the cost points have come down to the point where, even in our world, it make sense from time to time to put a robot where somebody was

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standing before, particularly when we've got some labor availability issues, and a lot of it is high technology based.

So, those are projects. I think there is a graphic on the slide deck that I used that is something that we're actually using in that area. That's – just to – and it's a great lever of operational productivity. It doesn't necessarily inflect the curve too tremendously, but it really helps us from a business perspective concentrate our efforts on very talented people and putting them in the areas where we're growing the company and growing from within as opposed to having to go out on the outside.

Bill, anything to add on that?

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

Yeah. And I would say, the returns on those investments are our highest return investments we can make. I mean, generally, 2 or 3x what we do on the inorganic side because the return profile, the margin impact, these are kind of 12- to 18-month return profiles for things on both the productivity and then the growth side.

Rob Wertheimer
Analyst, Melius Research LLC
Q

Okay. Thank you.

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

Francisco Amador
Analyst, Cowen & Co. LLC
Q

Good morning, guys. This is Francisco on for Joe. Could you talk a little bit about – just give us some detail on what you're seeing on municipal budgets, and any sort of expectations there around the infrastructure bill as well.

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

Sure. Well, I mean, there's always an interesting dynamic there. I mean, I would say, number one, the financial positions of most municipalities, certainly here in the United States, are probably thought to be better than they were, let's say, a year ago. There's a lot of the stimulus money and things like that comes in, and tax receipts generally been higher. So, I think just overall, financial condition is good.

Your question on the infrastructure spend thing is interesting. I mean, it – there's always a question of how long would you go from a concept to an actual project-based reality, and how long that takes. Ultimately, there's different parts of IDEX where that would actually help us in a good way. I'd point to our water business as one of them. There's a lot of talk in that bill about water infrastructure and the criticality there. I mean, one of our businesses does an awful lot of great work on sort of flow monitoring studies, which ultimately support CapEx projects. Like, you have to do one to then determine what it is you're going to buy in terms of CapEx.

So, I think we're well-positioned there, and there's some other pockets as well. But like always, it probably will take longer to play out and run through the system than we might imagine. But I would put it in the category just like in they're seeing, I think, from receipts in economics that it's positive; and certainly in a position that's better than I might have imagined it would be as we went into a pandemic.

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Francisco Amador
Analyst, Cowen & Co. LLC

Q

Thanks. That's very helpful. And if you could maybe talk a little bit about your expectations for fire and rescue. I know you guys have it down for the market outlook, but maybe a little bit more longer term what drives the recovery there.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Well, sure. I mean, our fire and rescue business is – I mean, they're phenomenal businesses. We've added to them over the years. We've got nice scalable concentration, and it's one of our most geographically dispersed businesses. You start with the premise that we've got incredible assets in that space. We've always said it was kind of a mature, steady market for us as a backdrop overall.

A couple of things going on there that, at least in the near term, probably put it into the red zone most for us. One is, that industry is – even before the pandemic, was struggling with output execution around chassis and trucks and things, and it's in a couple of different geographies. Obviously, what's going on now isn't making that better. And so just backlogs on fire trucks continues to be as long as it was a year ago, if not longer. So, you have a little bit of a moderation effect there.

And then, the emerging market side, specifically China, and we're definitely seeing – we've seen a couple of ways now of push for localization versus, in our case, we actually do a fair amount of imported products into that zone to complement our local brand there as well. And I don't think – long term, that hasn't necessarily impacted us, but it does impact us from a timing perspective; tends to keep tenders captive until we sort of see how it runs out. And so that's maybe the new element on top of the existing element in and basically a pretty steady market anyways.

I always encourage people, when they think about it, this is where like what we're doing in terms of our application sets on a critical job matter. So, like, the discussion we had earlier about automation and the things that we're doing to change the nature of the job is the exciting element with great, well-positioned global assets on a – you can still think of it as a mission-critical job, very steady-state. Generally, it's going to be something that's supported in the long term with funding and things. But it does go through certain ebbs and flows. And right now, it's on one of the more red-not-green zones, but we think long term is going to be fine.

Francisco Amador
Analyst, Cowen & Co. LLC

Q

Thanks a lot.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.

A

Thank you.

Operator: Our next question comes from the line of Bryan Blair with Oppenheimer. Please proceed with your question.

Bryan F. Blair
Analyst, Oppenheimer & Co., Inc.

Q

Thanks. Good morning, everyone.

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Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.
A

Hi, Bryan.

Bryan F. Blair
Analyst, Oppenheimer & Co., Inc.
Q

I wanted to quickly follow up on Nathan's question regarding your digital investment in fire and rescue. Any color you can provide on how we should think about that technology an extension of SAM capabilities?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.
A

Well, I think without spending too much time on lots of details here, you can think of it what the SAM unit – and, for the others on a call, this is essentially the brand name or the trade name for the automation that we do within a mobile application. That brings together a lot of important data points, some of which are related to our hardware, some are related to others that are in that mobile platform. And you can think of it in the simplest way as this technology that allows it to come off of the truck. It's a way to make that happen, to make it more mobile and less truck-based.

Bryan F. Blair
Analyst, Oppenheimer & Co., Inc.
Q

Okay. It sounds like a very natural expansion. And you offered...

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.
A

Do you think?

Bryan F. Blair
Analyst, Oppenheimer & Co., Inc.
Q

...an understandably nuanced answer with regards to the actionability of the M&A pipeline. In simple terms, can you share the size of the funnel relative to pre-pandemic levels?

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.
A

Yeah. No. I – certainly, in terms of ours, if we just listed up the things that are on there and added up potential transaction prices, it's larger. It's larger, I think, largely because of the work that we're putting in as we consider things and where we could go and how we could resource it with those people internally in the company and consider the firepower that we have to deploy. So, yeah, I think it's safe to say there's a larger funnel by potential transaction size.

Bryan F. Blair
Analyst, Oppenheimer & Co., Inc.
Q

Okay. Appreciate the color. Thanks again.

Eric D. Ashleman
President, Chief Executive Officer & Director, IDEX Corp.
A

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Thank you, Bryan.

Operator: There are no other questions in the queue. I'd like to hand the call back to management for closing remarks.

Eric D. Ashleman

President, Chief Executive Officer & Director, IDEX Corp.

Okay. Well, I'd like to thank you all for joining and spending some time with us here today. As we said in the prepared remarks in the beginning, I mean, really, really dynamic time with a lot of variables kind of swirling around.

What we talk about in our business is we get all of that and we deal with that on a day-to-day basis. But at the end, we ask people to take a deep breath, kind of come back and recognize that when a world kind of goes through what it's going through, it has a lot of problems that need to be solved. And the IDEX technologies that we have and the people that we have that drive them, they made up well with these kind of demands.

So, we've got well-positioned businesses. We've got incredible teams and talent. We're really, really focused. We've – we're now to a phase of 80-20 where it's very, very intuitive. And we're putting that to work in what's, no doubt, a dynamic and variable environment. At the end, I think the trade wins here are very favorable. We believe very strongly in our near-term and our medium-term, and ultimately the long-term prospects of the company, but recognize we kind of have to live moment to moment as we're going through this with an eye on the horizon. And I assure you, that's the one that we're thinking about the most.

Thanks again for joining us.

Operator: Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time, and have a wonderful day.

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