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IDEX Corp. (IEX)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the IDEX Corporation's Third 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, Allison Lausas, Vice President and Chief Accounting Officer. Thank you. You may begin.

Allison S. Lausas
Chief Accounting Officer & Vice President, IDEX Corp.

Good morning, everyone. This is Alison Lausas, Vice President and Chief Accounting Officer for IDEX Corporation. Let me start by saying thank you for joining us for our discussion of the IDEX third quarter 2021 financial highlights.

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

The format for today's call is as follows. We will begin with Eric providing an overview of the state of IDEX's business and an overview of our end market performance. Bill will then discuss our third quarter 2021 financial

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results and provide an update on our outlook for the fourth quarter and full year 2021. Finally, Eric will conclude with an update on the IDEX Difference.

Following our prepared remarks, we will 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 877-660-6853 and entering conference ID 13712091, or simply log on to our company homepage for the 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, Allison. Welcome to IDEX. It's a pleasure to have you on the team. I'd like to start by thanking Mike Yates, our former Chief Accounting Officer, for his 16 years of service to IDEX. Mike helped lead an evolution of our finance and accounting organization, and his work has had a long-lasting impact on the business. On behalf of the entire IDEX team, I wish Mike the best in his future endeavors.

Now, let's turn to our IDEX overview on slide 6. We continue to see supply chain challenges throughout the third quarter. Our localized sourcing, production and selling model helps us a bit relative to others, but this prolonged environment of poor material, labor and logistics availability challenges us just like any other business. Despite these obstacles, our IDEX teams around the globe have risen to the occasion. They exhibited both resiliency and stamina as they overcame yet another quarter filled with day-to-day disruptions, all while providing a high level of support to our customers. I want to thank all the IDEX team members across the globe for your hard work, not just in Q3 but over the last 18 months of business within a pandemic.

At this stage, we don't see any near-term signs of diminishing macroeconomic headwinds. Rather, we expect they'll remain at a high level and persist into 2022. We'll continue to leverage our 80/20 principles as we align around our best customers, our best prospects for growth, and our critical business priorities.

I spoke last quarter about our ability to capture price due to the differentiated mission-critical nature of our products. Overall, the price actions that we took over the past six months were increasingly realized in the third quarter, and we saw our price/cost spread increase sequentially. We will push price aggressively and appropriately as conditions continue to support our arguments.

Despite the many challenges out there, our organic performance remained strong. We set another record in the third quarter for orders, sales and backlog. Our backlog is now $186 million higher than it was at the end of last year.

Signals around the return of industrial projects have intensified and current energy prices, if sustained, have the potential to drive investments within IDEX application areas. Our Health, Science and Technologies (sic) [Health and Science Technologies] (00:04:53) segment performed exceptionally well. Over the past five or so years, we have stepped up organic investments with our focus on the longer term.

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Within our Sealing business, we built a new facility with the goal of capturing share in the expanding semiconductor market. We brought three optics facilities together in our new Optics Center of Excellence to enable future wins in life sciences by integrating multiple IDEX components to create value for our customers. We optimized the footprint and core technology of our Material Processing Technology platform to enable long-term, repeatable growth across a series of technologies. These investments have generated tremendous returns, and we are well-positioned to capture share and capitalize on market growth going forward.

On the inorganic side, our recent acquisitions are doing extremely well. ABEL Pumps is fully integrated and performing ahead of expectations. The Airtech integration is ahead of schedule and the team is making strong progress on their growth strategy. Both are executing well in the challenging operating environment as they come up to speed on our 80/20 playbook.

Our balance sheet remains strong and we have ample capital available to support future acquisitions and investments in the business. Our M&A funnel is healthy. Our expanded team has identified a number of interesting opportunities as we look to deploy additional capital in the near and long-term.

In the end, we are focused on delivering and growing within a very difficult near-term operating environment while spending a significant part of each day thinking about the best investments in teams, technologies and business opportunities to thrive in the years to come. I'm very confident in our teams' ability to outperform in both areas.

With that, I'll turn to our market outlook on page 7. In our Fluid & Metering Technologies segment, industrial day rates were favorable versus the second quarter. Larger industrial projects still lag, but quote activity and funnel strength have both improved. Agriculture remains robust, delivering on record volumes.

Our water businesses continue to perform well. Municipal spending is steady and there's general optimism around future increased government funding. The chemical and the energy markets continue to lag primarily due to limited capital investment. However, on the chemical side, smaller, fast-turning projects performed well. We are cautiously optimistic on energy as increased fuel prices and concerns over energy shortages have the potential to trigger investment.

As we noted last quarter, our Flow MD business has experienced a significant pullback in customers' capital investments. It impacted FMT's organic sales by 8%. In other words, excluding the impact of Flow MD, FMT organic sales would have grown 15% instead of 7% as reported.

Moving to the Health and Science Technologies segment, we continue to see strong demand across all our end markets. Semiconductor, food and pharma, analytical instrumentation, and life sciences all performed well. We continue to win share through our targeted growth initiatives and our intentionality around identifying opportunities that grow faster than the broader market is paying off. The automotive market remains affected by supply chain driven challenges, but we continue to see growth due to our concentration in higher end European vehicles. The industrial businesses within the segment saw a trend similar to FMT.

Finally, our Fire & Safety/Diversified Products segment is our most challenged segment right now. Price capture and volume offsets faced stronger headwinds within the segment due to higher direct OEM exposure and higher levels of material intensity due to vertical integration. In Fire & Safety, North America fire OEM production continues to struggle due to supply chain challenges. Larger tender activity is slowly increasing within the global fire rescue markets, but we feel these market challenges will persist into 2022.

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US automotive production pullbacks due to microprocessor shortages have tempered the performance of our bandwidth business. We continue to achieve new platform wins and believe we're well-positioned as supply chain constraints eventually ease. But in the third quarter, the impact of automotive shutdowns increased versus last quarter and moderated our performance.

Finally, dispensing performed well as key customers deploy capital on strong DIY market demand and our global product offerings captured share. We continue to closely monitor market conditions and expect rolling supply chain disruptions to continue throughout the balance of the year and into 2022. That said, our third quarter organic orders were flat sequentially versus second quarter and our backlog remains at a record level.

Overall, the demand environment for IDEX products has not waned despite supply chain challenges, and we remain optimistic about the trajectory of our end markets.

With that, I'd like to turn it over to Bill to discuss our financial results.

William K. Grogan

Senior Vice President & Chief Financial Officer, IDEX Corp.

Thanks, Eric. I'll start with our consolidated financial results on slide 9. Q3 orders of $774 million were up 36% overall and up 28% organically. We built $62 million of backlog in the quarter, and all three segments had strong organic performance versus last year, as well as versus the third quarter of 2019.

Third quarter sales of $712 million were up 23% overall and up 15% organically. We continue to experience a strong rebound from the pandemic across our portfolio, tempered by supply chain constraints. The Flow MD pressure in Fluid & Metering Eric discussed also had an impact on overall organic sales. Excluding Flow MD, organic sales would have been up 18% overall.

Q3 gross margin expanded 50 basis points to 43.8%. The increase over the prior-year quarter was primarily driven by increased volume and price capture, partly offset by inflation and supply chain impacts. Excluding the impact of a $9.1 million pre-tax fair value inventory step-up charge related to the Airtech acquisition, adjusted gross margin was 45% and improved sequentially.

Third quarter operating margin was 22.6%, flat compared to prior year. Adjusted operating margin was 24.3%, up 120 basis points compared to prior year, largely driven by our gross margin expansion and fixed cost leverage, offset with some pressure from targeted reinvestments and the dilutive impact of Airtech and ABEL acquisitions due to their intangible amortization costs. I will discuss the drivers of operating income in more detail in the next slide.

Our Q3 effective tax rate was 23.4%, which was higher than the prior-year ETR of 14.4% due to the finalization of tax regulations enacted in the third quarter of 2020, as well as a decrease in the excess tax benefit related to share-based compensation in the current period.

Third quarter net income was $116 million, which resulted in an EPS of $1.51. Adjusted net income was $125 million, resulting in adjusted EPS of $1.63, up $0.23 or 16% over prior-year adjusted EPS. The tax rate movement I mentioned drives a $0.27 differential in EPS as compared to the prior-year quarter. Said differently, our EPS would have expanded by $0.50, or 35%, had 2021 been taxed at the 2020 rate.

Finally, free cash flow for the quarter was $142 million, up 5% compared to prior year, and was 113% of adjusted net income. The result was impacted by higher earnings, partly offset by volume-driven working capital build. Our

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working capital efficiency metrics remain strong, and the teams continue to do a good job managing significant year-over-year volume and supply chain challenges.

Moving on to slide 10, which details the drivers of our adjusted operating profit, adjusted operating income increased $39 million for the quarter compared to the prior year. Our 15% organic growth contributed approximately $29 million flowing through in our prior-year gross margin rate. We achieved positive price/cost within the quarter and saw our price/cost spread improve sequentially. Our teams continue to drive operational productivity as another lever to help mitigate the profit headwinds we experienced from supply chain costs and associated inefficiencies.

The positive mix is primary result of the portfolio and business mix normalizing to pre-pandemic levels that had a negative impact on our results last year. As Eric mentioned, we are actively investing in the resources we need to execute on future growth and productivity. This reinvestment back into the business, higher variable compensation, and targeted increases in discretionary spending drive the year-over-year pressure of $15 million.

Despite the incremental spend, inflation, and supply chain-driven operational inefficiencies, we still achieved a solid 37% organic flow-through. Flow-through is then negatively impacted by the dilutive impact of acquisitions and FX, getting us to a reported flow-through of 30%. With a significant amount of focus dedicated to navigating supply chain disruptions, we did not fully execute on the level of spend we expected in the quarter. We intend to make these investments in the fourth quarter and they will mitigate our flow-through a bit as we close out the year.

With that, I would like to provide an update on our outlook for the fourth quarter and full year. I'm on slide 11. For the fourth quarter, we are projecting adjusted EPS to range from $1.55 to $1.58. We expect organic revenue growth of 9% to 10%, and adjusted operating margins between 23.5% and 24%. Q4 results are slightly lower than the third quarter, driven by organic and inorganic resource investments, seasonality, and the potential for year-end logistics challenges. The Q4 effective tax rate is expected to be approximately 23%. We expect about a 0.5% of top-line benefit from FX, and corporate costs in Q4 are expected to be around $19 million.

Turning to the full year, we are narrowing our full year EPS guidance from a range of $6.26 to $6.36 to $6.30 to $6.33. We are also maintaining our full year organic growth of 11% to 12%. We expect operating margins of approximately 24%. We expect FX to provide a 1.5% 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, in line with our previous guidance. Free cash flow is expected to be around 105% of net income, lower versus our last guide, primarily due to working capital investments. And corporate costs are expected to be approximately $73 million for the year. Earnings guidance excludes impacts from future acquisitions and any future restructuring charges.

Finally, beginning in 2022, IDEX will provide EPS guidance and report actual results excluding the impacts of after-tax acquisition-related intangible amortization. We believe reporting adjusted EPS on this basis will provide more transparency to our core operating results, as well as facilitate comparisons with our peer companies as we continue on our capital deployment journey.

With that, I'll throw it 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 12. Before we open the call up to questions, I'd like to share a few updates around our great teams. First off, I'd like to extend my public congratulations to our Non-Executive Chairman, Bill Cook on being named Public Company Director of the Year by the National Association of Corporate Directors.

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Bill and I both joined IDEX around the same time in 2008 and I've learned a great deal from him over the years. His insightful perspective and critical thinking skills have been tremendously helpful for the company. And I know I speak for everyone at IDEX when I say congratulations, Bill, on this well-deserved honor.

Turning to the IDEX Foundation, last month, the Foundation entered a national partnership with the Boys & Girls Clubs of America. Various US-based business units have supported their local boys and girls clubs over the years, but this takes our joint work to the next level, offering a clear pathway for increased engagement. Every one of our US business units is close to at least one Boys & Girls Club location. This agreement aligns with the Foundation's Equity & Opportunity charitable pillar added earlier this year, seeking to create opportunities for underserved, disadvantaged people of color within our communities.

Finally, we attribute much of our success to our strong foundational culture. Our annual September engagement survey just came back. And even within this incredibly challenging environment loaded with disruptions and unexpected turns, we held steady and we're scored in the top quartile of all manufacturing companies. Our teams around the world are beginning to develop tactical plans to address feedback provided by their local teams, part of the continuous improvement that supports everything we do at IDEX.

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 Nathan Jones with Stifel. Please proceed with your question.

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

I think we lost Nathan.

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

Can you hear me?

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

Now, we can.

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

Now, we can.

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

Okay. All is well that ends well. So, first question just on this discretionary reinvestment. It wasn't called out on the walk in the first quarter, ramped up in second quarter and third quarter. And I think Bill said in his comments that

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you didn't actually spend as much in the third quarter as you intended. I think that margin guidance for the fourth quarter is down a little bit. Is that all just coming from the extra discretionary reinvestment in growth that you guys are looking at in the fourth quarter?

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

A

Yeah, I know exactly. I think the teams have done a good job managing and focusing on the critical things that we need to invest within the business. In the third quarter relative to – obviously, there's high demand for labor across a bunch of businesses in a bunch of different geographies, and some head count and other items that we thought we would have landed in the third quarter just got pushed to the fourth quarter. So that'll come back and put a little bit of mitigation on our overall flow through, but still relatively strong.

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

Q

Okay. Then one of the things I got from your press release was a quote where you said macro constraints that inhibit customer satisfaction. I assume that means that all of these constraints are leading to lower on-time delivery metrics for you guys. Can you talk about how much that slipped? If there's any anticipation you'll be able to get them back up quickly and if that impacts your ability to push pricing at all?

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

A

Sure. Well, it's less a function, Nathan, of on-time delivery and actually a function of extending lead times and then hitting those commitments. So, I mean, we've maintained a high say-do ratio relative to our customers. We use the 80/20 lens to provide differentiated services for different levels of customers. So, all of that remains constant. But in this environment, the part that I think we're all struggling with is just inherently the lead times in the queue is lengthening. So it's really that.

Your question around when does it resolve, I think as we indicated, it's further out on the horizon quite honestly. I mean, bunch of the knobs have to turn together in material availability, labor availability across the spectrum and logistics. So as those start to move and start to move in and all of us can depend on higher levels of throughput, we would be able to bring lead times back in and ultimately against all of that still maintain that high say-do ratio. So it's again less on OTD rates and more on just lengthening lead times against expectations.

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

Q

And does it impact your ability to push price at all or are customers just conditioned at this point that lead times are extending and they just have to deal with it?

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

A

Yeah, it really hasn't interfered. I mean, one of the things we're always tracking is lead times relative to our typical traditional performance as well as then competitively. And because our model has generally been advantaged this way, it remains so on a relative basis. So as long as that holds, that generally keeps all of the arguments and the equations where we like them.

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

Q

Great. Thanks for taking my questions. I'll pass it on.

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

A

Thanks, Nate.

Operator: Our next 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.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Hey. First, welcome to Allison, best of luck. Secondly, great to see you guys moving to cash EPS. It makes all kinds of sense for you, put you on that level playing field with your growth by acquisition peers. So, great move. No surprise there. So thank you.

The question – so let's just roll the clock back to last quarter, and I think you guys are one of the few that thought that the whole supply chain inflation had plateaued, but it really has not. Maybe if you could just – you've kind of given the description and we've heard from everyone about inflation, supply chain, labor, et cetera. But where are you feeling the greatest pain? And is there – just to clarify on Nate's question, are there any – have missed out on revenues and can you quantify that?

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

A

Okay. So, look, I mean, supply chain has been a tough story for at least six months and it'll continue here into the fourth quarter. We didn't say it had plateaued. We said that relative to a pretty tough situation. So tough in the second quarter, tough in the third and continued tough in the fourth with, frankly, some year-end dynamics that always make that quarter a little bit tougher. And so, we're thinking of those as we project forward.

Your question around what are we experiencing, well, I mean, there's a lot of variety in IDEX. But one thing that makes us all about the same is we tend to buy a lot of configured materials. We're not overly vertically integrated, so material availability is the number one challenge. And then it does vary.

We've got some businesses, a few that are more semiconductor and chip intensive. And then as you suspect, those tend to be the items for those businesses. Others, it's things like motors, and castings. And typically, if they're coming from further away, that's a harder challenge.

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Labor availability for us, we don't have labor as a high percentage of our sales, but we do have pockets and it tracks pretty uniformly where labor is scarce, either in the US or in other geographies. And I'd say, as an overlay, I'd probably say all of IDEX, to some degree, is continuing to try to track down scarce logistics resources, especially on smaller shipments or things that are going overseas.

So, I know that pretty much covers the spectrum of all possibilities. But if you want to just put a bow around for us, it's material availability coming in through a supply chain of configured materials.

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

And then, Deane, maybe to your lost revenue comment, I think holistically, no. Obviously, we've got critical products across the portfolio that are spec-ed in in high demand. This isn't a commodity application where folks if they can get it a week faster for a dollar cheaper, they're going to go with that product. So, relative to lost revenue or our ability to capture price, the differentiation we have with our technology continues to support our incremental price increases across the different businesses.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

All right. That's all really helpful. Just last one for me is, you commented on record backlog. Is there an extended lead times? Is there any chance that you'll need to go back and reprice any of that backlog? Just the older it is, the more that material cost inflation weighs on it and so forth. What's your flexibility there?

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

Yeah. Where we have the ability to do that, we're not contractually constrained, we have done that as we've progressed through the year. Yeah.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Great. Thanks for all the help.

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

Thanks, Deane.

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

Hey. Good morning, everyone.

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

Good morning, Mike.

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

Q

So, couple questions here. First, a lot of moving pieces in the environment as we sit here today. Certainly appreciate the color that you gave us, and I guess, in this case, literally the green and red colors you gave us on the various end markets and how those were performing. Maybe you can just start triangulating some thoughts on how you're thinking about those markets as we move into next year and maybe even through the next couple years, your concern level with all of these supply chain challenges, degrading demand, having some sort of circular challenge versus how you think about sustainability of the recovery curve as we sit here today and just how you balance all those moving pieces out internally.

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

A

Sure. So there's a couple of things there. Yeah, relative to kind of the green and red chart that we provide folks, it hasn't changed a lot over the last couple of quarters in terms of the few areas that are lagging. So I'll sort of leave those as those stories continue in energy and chemical, and we can go into those later if we like.

But I'd say a few things that are new here would be the automotive side did flip over to red for us. There's just no question been more disruption, more shutdowns, even on the higher end stuff where our products tend to have good presence. Again, small piece of IDEX, but it is something that's changed and changed a little different.

I think if you kind of come up to a segment level, I mean, as you can see from our prepared remarks and just in our numbers, I mean, the Health, Science, Technologies (sic) [Health and Science Technologies] (00:27:37) segment is doing really, really well, very, very strong. We've got semiconductor, that's where our exposure is. That's a strong market. Anything in analytical instrumentation, life science, the food areas, we've got some pharma in there as well, those are just kind of universally strong, and we would expect those to continue strong going forward.

I think we talk a lot, of course, when we turn over to FMT, around project business and the nature of those. And we have seen some movement there. This has been a slow march of progress through the year. But I would say in the areas of food and pharma in particular, you are starting to see a shift towards some intentional capacity expansion, which lends itself into discussions with folks like us and others around project business. In places on a more classic FMT side of the spectrum, chemicals, energy, that's lagging on the other side. Although even in chemicals, some of the faster turn projects, we're seeing those come about.

And then in that sort of right down the middle of the fairway industrial environment, where a lot of our FMT businesses play, the discussions continue to move, and we are starting to see a bit of that hit the order board or at least indicate that it will in the first part of 2022. So, I wouldn't say that the acceleration curve is different, but it continues to move more positively.

Second part of your question was really around sort of this supply chain condition and its run-out. I think we were just talking about this this morning. What would be interesting is, overall, I think this is playing out indicating that there's still a lot of capacity that has to be put to work in the industrial space. You got too many places running 12 hours, 13 hours, and running their equipment into the ground. Then some of the challenges with labor scarcity, I mean, that lends itself towards automations and other things that are going to provide some support.

So, I do feel good about the longer range winds at our backs and others in the industrial space. The near-term challenge, of course, is that we're sitting here and a lot of other companies are sitting with a lot of backlog, and in

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some ways, kind of a steady output that we wish was higher because of the supply chain challenges, eventually those two lines cross. I would like to think that what would happen is the throughput would continue to increase as capacity is applied, as people come back to work and begins to catch that order rate, and then it continues in a great direction.

I think that's the open question for all of us is sort of how do these things resolve – those two rates resolve over time in the, let's say, the next two quarters coming into 2022. And so, we're going to have to watch all of the inputs and the variables that are driving that. It's a pretty complex equation, of course. But I'd end with saying, continued positivity, the rates of progression are – we're seeing those, feeling those, and feel good about them. It all kind of comes down to a few things that are variables in the near term.

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

Q

Appreciate that. And then just usual kind of update, M&A outlook, how you think about funnel actionability, any color around that?

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

A

Yeah. Yeah. I mean, very good. As we've talked about through most of the year here, we were intentional of putting some more resources on this job. So we're looking at more projects, more interesting ideas, we're out there traveling around. We're kicking the tires on a lot of things and have a strong funnel in a variety of areas, both things that apply to IDEX businesses and are in close universes, as well as kind of an open lane of things that are interesting and IDEX-like that we might consider over time. So both in good shape, and we're excited about prospects there as we go forward.

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

Q

Thanks, everyone. Appreciate it.

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

A

Thanks, Mike.

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 & Co.

Q

Thanks. Just with respect to the change in reporting as it relates to acquired intangibles amortization, what is that number, Bill, for IDEX expected to be in 2021? And if you have something you can give us for 2022, that might be helpful. And then I have a follow-up.

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

A

Yeah, Matt. We'll give guidance on what that number was for 2021 and our go-forward guide once we come out with our numbers late January.

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

Q

Okay. And then with respect to Flow MD, the volatility you've seen in that business, Eric, seems a bit outside of what I'd tend to call an IDEX-like business. And I was wondering if you could just give a little more thoughts on how we should be thinking about that going forward.

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

A

Sure. Sure. Well, it has some attributes. It's very IDEX-like in terms of the problems it solves and its sort of position on the bill of materials for the fossil fuels infrastructure in the country. So, that is typical.

But you're right, relative to the average IDEX business, the unit of measure or the sale price of the product is a lot larger. These are pretty large units. In fact, the nature of projects, in terms of how those orders come to us, are larger as well. Tends to be very much a capital intensive kind of way of doing business.

And so, this is a business that, remember if we just back up over the last year when we acquired it, had really, really high levels of backlog because they captured a lot of projects long ago prior to the acquisition. Then, of course, things change pretty dramatically in terms of how the major folks that are in charge of the pipelines in the US were talking about capital spend. We burned off that backlog and now find ourselves kind of in a steady state against replenishments and maintenance projects.

We do a few things internationally. But the core of this business is still ultimately around the build out or refurbishment around pipeline infrastructure in the US. It comes in larger project increments and the sale price of the end product is larger.

So for all of those reasons, the magnitude year-over-year is a larger swing than you would typically see in IDEX. That's why we've been careful to call it out and make sure people understand it within the FMT results.

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

Q

Got it. And then, just one final one. Just in terms of pricing, you typically get somewhere in the range of 100, maybe 150 basis points in a good year. And I'm curious as to where your realization is on a year-over-year basis at the present time and how much of that should be viewed as more – as permanent in nature versus maybe some of that's more surcharge like. So any color you could provide there would be helpful. Thank you.

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

A

Yeah. No. So we're in excess of 200 basis points this year. It'll be a record year for price capture for the organization. Majority of it is permanent price increases. Obviously, we'll look at surcharges on the freight side as that's been much more variable to offset that, but most of it will continue on into our base level pricing for 2022.

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

Q

Great. Thank you, guys.

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

A

Thank you.

Operator: [Operator Instructions] 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. Good morning and welcome, Allison. Eric, I want to go back to your comment and just kind of beat this up a little bit more. Supply chains tempering a little bit of the growth. I guess, one, is there a way to quantify sort of what that impact was in the quarter in terms of maybe lost 1 or 2 points of organic?

Then I guess, and then along with that, Bill, you talked about working capital, some increases there. And I suspect, part of that is a supply chain issue. Is there an opportunity here for you guys to attack, maybe more fully in the first part of next year, some of those lead times and start to bring them in a little bit? Just any color there.

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

A

Sure, Allison. In terms of output, we could have realized with a slightly more favorable backdrop in the supply chain, probably in the range of a couple of percentage points of the organic rates that we posted. Just simply had the order could have made it and can point to something that prevented it in one of those three categories that I talked to.

I'll let Bill talk about the inventory. We'll say we – like many businesses, on critical material, if we can get it, even if it doesn't meet up perfectly with some other things, we'll take the spot and take the material. So, there's a little bit of investment in working capital there.

I think the last part of your question around can we attack it, I think like a lot of other businesses, we're scrambling to lift our capacity and help our supply chain in any way we can on all dimensions. So, some businesses are attacking the labor scarcity issue in very unique ways and very innovative, quite honestly. Most of it comes down to, in some places, capital spend. We're doing some things and thinking through capital that we know we have to put into the business. So we've kind of watched that ramp throughout the year, and that makes sense and wherever possible.

IDEX is not an easy business to automate, but we're doing it more than we have been before because it also helps solve the labor issue. Sometimes it comes down to design, which is something that people don't think a lot about. But sometimes you can actually alter designs, whether it's in simple circuitry or even some of the other parts that we have and assist with fabrication. This is where our local proximity really helps us, so we can get in a car and drive over to a supplier and kind of have a collaborative discussion of is there a different way to solve this problem and bring material in.

So, it's pretty much every day. If you went to one of our daily management sessions, you'd probably see that 70% of the discussion is around solving problems of this nature over the short-term and then wherever possible and longer term in terms of investments in problem solving.

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

A

Yeah. And I think there will be opportunities in the working capital side once things normalize, but time will tell when that is. We're assuming back half of next year, but we'll see.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Got it. And then just in terms of HST, strong quarter there and you'd mentioned, obviously investments have been starting – certainly contribute to core. Is there a way to quantify sort of what that contribution to core was this quarter as well as any comments on sort of the mix impact that some of those investments are having in terms of those products being delivered today?

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

A

Actually, when you look across the portfolio, there's been robust margin expansion, almost – well, I shouldn't say almost – in every single reporting unit. Since we have, we highlighted a couple, but there's been targeted investments in all entities within the HST segment that have you just look at the overall margin expansion that we've experienced there as we realize some of the incremental revenue associated with it and because of the differentiated nature of that technology, the high margin associated with it, we did have – some folks highlighted – sequentially the margin was down in HST, but that's really due to Airtech coming in in the portfolio. On a like-for-like basis, margins are still at kind of those all-time highs we saw in the second quarter and look for that on the core to continue here as we go forward.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you.

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

A

Thank you.

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

Q

Hey, good morning. This is [ph] Robert (00:39:06) in for Joe. Yeah. I just wanted to touch on orders again. Do you have any sense of how much your customers are trying to, like, build their inventory? And I guess also like, how much of your order activity feels consistent with like actual demand trends?

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

A

Yeah. No. It's a good question. I mean, so a couple of things. One is, when you think about the nature of most IDEX products, it's highly configured, in some ways customized for each application. And so, typically, it's not a

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great product to over order a laptop because you're never quite sure of how it's going to run out in the customer system.

I would say, what is a little different as we go through the year here in terms of typical patterns is just lengthening of sort of order horizon. So if somebody would have before given us, let's say six months' worth of requirements, they might throw another quarter in there, recognizing, hey, this is a standard product. We know we're going to use it in this particular case, and we don't want to lose a place in line. That tracks actually with our own lead times. As we extended those lead times, most equations would work and say, then that's how you would change your order patterns to accommodate it.

So, really, we've never seen a tremendous run up of inventoried IDEX material. Our distributors and channel within FMT doesn't really work that way. Most people still, as they think of planning for IDEX products, think of us is generally on the very agile, reactive end of the spectrum. And they haven't really changed their thinking around it as the entire world kind of goes through a relative change and shift outward.

Q

That's helpful. Thank you for that. And then, I guess, I have a quick one also just to follow up on the M&A pipeline. It sounds like you said it's very healthy and integration of Airtech, which is one of your largest acquisitions to-date, is going well. And with all the focus that you have internally on those initiatives going forward, This might be a break from previous acquisition behavior, but would you all be considering anything more transformational in nature, like a really big acquisition that might be like a new segment or something like that?

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

A

Well, I mean, I'd say two things there. One, we always consider kind of every chapter within possibilities, things that are very small like little pieces of technology we want to tuck in. Things like Airtech or frankly ABEL Pumps, which are more typical of IDEX transactions in the past.

And then we do consider from time to time things at the other end of the spectrum that are larger. I think you always want to exercise that muscle, but we're always careful to say for something in that category would have to have very IDEX-like characteristics to mitigate risk. And there's just not a giant universe of things that are in that particular bucket. And if there were, actionability is always somewhat of a question.

And so we do consider it from time to time. We don't turn that switch off, but we recognize the probability is generally lower for the reasons that I suggested there, just thinking about how it would mix and complement IDEX and where it would attach given the large size that you're describing. But every one of those chapters is something that we kind of walk it down as a book in our own phone calls.

Q

That's great. Thank you very much.

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

A

Thank you.

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Operator: There are no further questions in the queue at this time. I'd like to hand the call back over to – no, we do have another question from the line of Rob Wertheimer with Melius Research. Please proceed with your question.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Howdy, everybody. Looks like I got to work on my hidden star one skills. Sorry for that.

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

A

Hi, Rob.

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

A

Hi, Rob.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Just a little bit curious if you can give more background around the targeted spending. You mentioned Fire & Safety cost pressure mitigation and/or whatever. And then you've been talking about the discretionary investments for a couple quarters. I know last year, there was obviously some discretionary cuts. But just generally speaking, are you seeing more opportunity or are you trying to change anything in the way you attack opportunities with these investments? Thanks.

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

A

Sure. I mean, generally, when we talk about growth investments in IDEX, they often walk on two legs. I mean, there are people that we're going to bring into the business with specific skills for the charter to go focusing in front-end areas, usually on the commercial side or strategic or thinking around putting the balance sheet to work.

So, there are other things that we'll do, sometimes third-party services, a couple of things in terms of nurturing and shaping technology. But a lot of times, it comes down to people-based investments, and just amping up the ability to go out and study things and spend time in the field, get the inputs that we need to then begin to modulate the technologies that we have in-house or those we might bring in.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Okay. Perfect. That's a helpful response. And then just in Fire & Safety and then just the path to – I don't know, the path and mechanisms on recapturing some of the cost pressures there, and I will stop. Thank you.

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

A

Yeah. I mean, it's just a little off the IDEX typical. We do, as we mentioned, have a little bit more OEM concentration there. This is where some of the larger project work tends to be as well. You put the two things

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together, and you're not as able as we are in FMT and other places to just sort of go out and make those discrete changes quickly.

So, it doesn't mean we don't get that capture. The margin performance over time would absolutely verify that we do. It's just it does tend to lag a little bit from the rest of the more typical IDEX locations. But the pricing arguments around criticality of solution and leveraging our position, our number one share position within those niches and our long relationship with customers, that's basically the same equation. It's just you have to be a little bit more cognizant of the timing and the duration of projects and things that are just a little different there. So we wouldn't see this as something that's going to dramatically alter the margin performance of that company over time or those businesses. But it will take us a little longer to catch up here.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Okay. Thank you.

Operator: Our next question comes from the line of Vlad Bystricky with Citigroup. Please proceed with your question.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

Good morning, team. Thanks for taking my call.

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

A

Good morning.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

So just wanted to follow up on some of the reinvestment that you're doing, and particularly, given supply chain and logistics issues you see out there now, has your thinking about where you're targeting investment dollars evolved or changed over the course of the year, as you've seen these supply chain and inflationary pressures continue to increase and not really get any better?

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

A

Yeah. I mean, it's a great question. And the short answer is no. When you consider the cycles of our business, one of the things that's really, really important is that even as near-term things like supply chain challenges, all the stuff we talked about disrupt the day to day, and maybe that even continues for a series of quarters, the bets that you're going to make, you got to consider as you're making them today to sometimes flourish two, three, five years in the future.

I was reflecting when we talked about all the positive aspects that are happening in HST, many of which were coming out of specific facilities that we bought for specific reasons to get it at different markets. Actually went back and checked the dates, those were commissioned in 2016, 2017, and 2018 basically and are now at full fruition here. And we're very glad we made those bets. So, we just have to be very aware of sort of longer-term trends, longer-term positioning, and make sure that we're both doing two things simultaneously: one, reacting

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appropriately to the disruptions in front of us, but also projecting and extending ourselves into 2023, 2024, 2025, and making sure that those bets and those first discussions around growth are actually happening now.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

Okay. That's really helpful. Thanks. And then maybe just shifting gears a bit, I know Asia is a smaller piece of the mix for you versus the US and Europe. But can you talk about what you saw in terms of growth trends in the region over the course of 3Q and into 4Q, given the evolving COVID situation and policy...

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

A

Sure.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

...responses in countries like China and Malaysia?

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

A

Yeah. And I'd preface both, I mean, most of our areas where we play, we've got a campus in India, a campus in China, and then we've got some commercial things across broader Southeast Asia. I would say, in general, those have performed very well for us the last few years, they have performed well in 2021.

I remind everybody it is a smaller portion of IDEX and we attack it in a really surgical way. So, we're picking specific niches, specific applications, and then mating up technologies that we have available in IDEX to go after those that. I mean, we're picking them because we think in many times, they're somewhat immune to some of the ebbs and flows that you would see more day-to-day or quarter-to-quarter because they've got growth dynamics at their back. So we're doing things in air ventilators and things for high altitude or paint dispensing. It's a great market across all of that region for that specific reason.

Now, specifically, I would say we – as a backdrop, I don't think we're seeing things that are different than others have talked about in terms of more moderate growth rates in China. And in a couple of instances, I'll just talk to China specifically, we have some headwinds where there's – and we mentioned this – there's a build for China belief out there around certain markets and things that they are very interested in investing in and that provides headwinds for us. But I would say that's where innovation kicks in. What we're able to offer is quite different than the local option. It just means the sales cycle is extended a little longer, a little harder, but ultimately, we think our differentiation wins there. It's been a great performing region for us.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

Okay. That's very helpful. Thanks.

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

A

Thanks.

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Operator: There are no further questions in the queue at this time. 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, thank you. Again, I'd like to welcome Allison to our team and our session here and thank everybody for your interest and your time today to hear what's going on at IDEX. As we said, it's a really interesting time, a lot of challenges out there.

My closing comments would be for those IDEX associates that are on this call. Again, I really want to thank you. I know how hard this is in terms of the day-to-day challenges you have. I know you're doing the right things for the customers, for the business, and for your colleagues, and frankly, your communities as well. So thanks to everybody, and I wish you all safety and prosperity in the days and weeks ahead.

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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