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IDEX Corp. (IEX)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to IDEX Corporation Second Quarter 2022 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 Allison Lausas, Vice President and Chief Accounting Officer for IDEX Corporation. Thank you for joining us for our discussion of the IDEX second quarter 2022 financial highlights. Last night, we issued a press release outlining our company's financial and operating performance for the three months ended June 30, 2022. 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 are Eric Ashleman, our Chief Executive Officer and President; 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. Then, Bill will discuss IDEX second quarter financial results and update on segment performance and the markets they serve, and our outlook for the third quarter and full year 2022. 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 number, 877-660-6853 and entering conference ID 13724804, 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 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 and President, Eric Ashleman.

Eric D. Ashleman

President, Chief Executive Officer & Director, IDEX Corp.

Thank you, Allison, and good morning, everyone. I'm on slide 6. IDEX delivered outstanding results in the second quarter. We achieved record sales levels; 12% organic growth supported by double-digit contributions from each of our operating segments. Our backlog grew by $43 million, and we now sit at record levels to continue momentum into Q3.

Core profitability continues to be strong even as we return to more normal discretionary spend levels, allowing us to fully invest in our best growth investments. We delivered record adjusted EPS of $2.02, an increase of 15% over the prior year's second quarter. Last quarter, I described how our IDEX teams leveraged 80/20 to accelerate throughput within a challenging supply chain environment. That positive momentum continued into the second quarter as our teams improved their ability to execute and deliver for our customers. Our decentralized operating model, which aligns decision-making at the point of impact close to the customer, drives the speed and agility

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required for us to outperform. Our lead times were a competitive advantage and enabled share gain in pockets across the company.

Inflationary pressures remain, but the rate of increase decelerated while we continue to capture price equivalent with our differentiation. Gross price capture increased and we expanded our price cost spread trending back towards historic levels. We remain committed to our capital deployment strategy and M&A remains a top priority for us. This quarter we closed on the acquisition of KZValve, a complement to our agriculture business within FMT. Our pipeline is strong and we continue to evaluate opportunities in higher growth markets that support our style of competition. We have a healthy balance sheet and are confident that we can continue to put our capital to work.

We're also deploying capital organically across our portfolio to drive operational efficiencies and increase capacity to support our growth. We continue to make investments in commercial, engineering, and M&A resources to enable us to execute on our strategy.

During the quarter, we increased our share repurchases and deployed $88 million to buy back 475,000 shares of IDEX stock. We remain disciplined with our methodology to create long-term value for shareholders, when we see a disconnect between our intrinsic assessment of IDEX enterprise value and our public valuation.

Lastly, in the second quarter, our board approved an 11% increase in our dividend. Rising interest rates, continued inflation, and geopolitical dynamics all present some uncertainty for us as we consider and head into the second half of the year. But we're not yet seeing any major signals of near-term slowing within our commercial environments. We have good line of sight to the next 90 days, and we continue to see strength in almost all our end markets. As we look across the industries we serve and our portfolio of differentiated technologies, we're confident that IDEX is well-positioned to outperform during any short-term market volatility. It's been a really strong first half of the year and our teams have a lot to be proud of, but it's not easy to over-deliver in this environment.

I'd like to thank our IDEX employees around the globe for their hard work, diligence and agility as they execute for all our stakeholders. With that, let me 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 8. Q2 orders of $839 million were up 12% overall and up 7% organically. We experienced strong orders growth in HST and FMT, but saw contraction in FSD (sic) [FSDP] (00:05:51) driven by dispensing North America's strong replenishment orders received last year.

Second quarter sales of $796 million were up 16% overall, and up 12% organically. We experienced record sales with double-digit increases across all three of our segments. Second quarter operating margin was 23.4%, up 30 basis points compared to prior year. Adjusted operating margin was 23.8%, down 60 basis points. Incremental amortization related to Airtech, Nexsight and KZValve acquisitions unfavorably impacted adjusted operating margin by 80 basis points.

Second quarter net income was $138 million, which resulted an EPS of $1.81. Adjusted net income was $154 million, resulting in an adjusted EPS of $2.02, up $0.27 or 15% over prior year. Finally, free cash flow for the quarter was $97 million or 63% of adjusted net income. This reflects higher accounts receivables driven by the significant increase in sales versus last year, as well as elevated inventory levels. Inventory has increased to buffer supply chain challenges and leverage material availability as a competitive tool to take share in the market.

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We have spent a lot of time with our teams reviewing their inventory reduction plans and are targeting to bleed down our inventory positions in the second half of the year.

Moving on to slide 9, which details the drivers of our adjusted operating income. Second quarter adjusted operating income increased $23 million compared to last year. Our 12% organic growth contributed approximately $22 million, flowing through at our prior year gross margin rate. We levered well on the volume increase. Our teams drove operational productivity and we had strong price capture to offset inflation headwinds. Price cost was accretive to margins and is trending towards our historic levels. We experienced positive mix of $2 million across the portfolio. We reinvested $4 million mainly in the form of engineering and commercial resources to drive long-term growth and additional resources to support our accelerated M&A activity. Lastly, discretionary spending increased by $9 million versus last year and up $7 million versus the first quarter of 2022. Our teams across the globe are back to in-person partnering with our customers, actively marketing our products, and investing to support innovation.

As we look ahead to the second half of the year, we do not expect this level of sequential increase to continue. We've now ramped to our pre-pandemic spending rate, but on significantly higher sales. Our organic flow-through is 23%, in line with the flow-through expectations we set at the beginning of the year, but most likely the lowest rate we will experience this year. Flow-through is then negatively impacted by the dilutive impact of acquisitions and FX getting us to a reported flow-through of 21%.

With that, I'd like to provide a deeper look at our segment performance.

I'm on page 10. In our Fluid & Metering Technologies segment, we experienced a strong second quarter for both orders and sales with organic growth of 8% and 13%, respectively. FMT adjusted operating margin expanded by 170 basis points versus last year. The increase included 60 basis points of headwind due to incremental amortization related to the Nexsight and KZValve acquisitions. Volume leverage, strong operational productivity, and favorable price costs were the main drivers of the increased adjusted operating margin. Our industrial markets are exhibiting stable demand with consistent quote activity over the last few quarters. We are seeing small to midsize projects coming through in the oil and gas and petrochemical markets, as well as in applications tied to mining, asphalt and lithium-ion battery production.

Agriculture continues to perform well. Farmers are experiencing record inflation and look to our technology and Precision Ag to drive productivity. The KZValve integration is going extremely well and our automation project at Banjo is on track.

Market conditions remain favorable in our Municipal Water business. We continue to see a strong commercial funnel and long-term optimism driven by government funding and ESG initiatives. On the energy side, upstream markets are experiencing healthy demand with oil prices providing strong support. Mainstream investments have yet to see a bump in activity due to customer supply chain constraints and caution on long-term price sustainability.

Moving on to Health, Science and Technology (sic) [Health & Science Technologies] (00:10:44), Stellar commercial performance continues with organic orders up 13% and organic sales up 12%. HST adjusted operating margin contracted by 130 basis points versus the second quarter of 2021. Incremental amortization related to the Airtech acquisition unfavorably impacted adjusted operating margin by 130 basis points. Additionally, adjusted operating margin was driven by strong volume leverage and positive price cost, partially offset by increased employee-related costs, discretionary spending and resource investments.

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HST continues to benefit from strong secular growth trends within life science, analytical instrumentation, semiconductor and food and pharma markets. The life sciences market is experiencing strong demand for next-gen sequencing instruments and consistent core diagnostic market performance. Analytical instrumentation and material processing results remain strong on continued pharma and biopharma demand.

On the semiconductor side, we continue to see growth, but at a slower pace. We've been able to offer shorter lead times than our competitors, enabling share gain across a variety of applications. We continue to see strong growth in our optics businesses tied to broadband satellite technology and strength in our industrial businesses, similar to the FMT results.

Finally, turning to our Fire Safety & Diversified Product (sic) [Fire & Safety/Diversified Products] (00:12:11) segment, orders contracted by 5%, but sales were strong with organic increase of 11%. FSD adjusted operating margin contracted by 280 basis points versus the second quarter of last year. This was driven by higher volume being more than offset by higher employee-related costs and discretionary spending, as well as pressure on price cost due to aged OEM backlogs on the fire side and automotive exposure with more metal content within BAND-IT. As we noted in prior calls, we have taken action to address this gap and expect the price cost will improve in the second half of 2022 as those increases pull through our backlog.

Our dispensing business performed well, driven by delivery of North American project volume and an overall positive global paint market. BAND-IT had strong results across the industrial, automotive, and oil and gas markets. On the automotive side, we continue to outperform the market and capture share on new platforms. In energy, we see strong downhold market demand and capture share due to material availability with shorter lead times for our customers.

Within Fire & Safety, we are seeing strong demand with our E3 Rescue tools. On the Fire side, core North American and European markets remain choppy due to OEM supply chain constraints, but we are starting to see some modest improvement. With that, I'll provide – like to provide an outlook for the third quarter and our full year 2022 results.

I'm on slide 11, which lays out our updated guidance. For the third quarter of 2022, we are projecting organic revenue growth of 9% to 10% and operating margin of approximately 24%. Q3 forecasted op margin is up slightly versus second quarter due to improved price cost, partially offset by lower seasonal volume leverage. We expect GAAP EPS to range from $1.80 to $1.85, and adjusted EPS to range from $1.98 to $2.03.

Turning to the full year, given our strong performance in the first half of the year, we are raising our full year guidance. We now expect full year organic revenue growth of approximately 10%. This reflects our confidence in line of sight for the third quarter, but some caution in the fourth quarter due to the short cycle nature of our business.

We expect GAAP EPS to range between $7.19 to $7.29 and adjusted EPS to range from $7.88 to $7.98. Our operating margin for the full year is expected to be approximately 24%. We are expecting free cash flow as a percent of adjusted net income to range from 75% to 80%, down from our previous guidance. With our higher revenue expectations for the back half of the year elevating our year-end receivables balance and a slower than expected inventory bleed, this is our best estimate as we head into the second half of the year. Our long-term goal remains to be above 100% and consider the current guidance reflection of the volatile external environment versus a structural shift in our cash generation capabilities.

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

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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 Mike Halloran with Robert W. Baird. Please proceed with your question.

Michael 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.

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

Q

So let's start with the comment, Eric that you said you're really not seeing anything yet in terms of deterioration and things are going well. And you can certainly hear that from all the end market commentary you guys gave. And then, balance that with the guidance outlook that says you're taking a little bit more of a cautious outlook into the fourth quarter given short cycle business, you don't know what you don't know. So, maybe just talk about those two competing things and what things you're looking for in your portfolio to say that things are going to keep this pace, maybe decelerate, could be the BAND-IT business, could be something else, but would love to kind of compare, contrast all that stuff.

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

A

Yeah. Well, thanks. So, we're always, always looking at what we referred to as our canaries in the coal mine businesses. Those are the shortest cycle. More industrial businesses, they are very, very close to the actual consumption. It's going on out there in the industrial landscape. And those have held up really, really well. I mean, I think that's the story of this whole post-pandemic recovery is just that industrial system that's been working feverishly to try to catch up. So, yeah, that for us is always something that we're looking at first to see if there's an indicator of weakness there that usually sends up a signal and then you start to see things come after that. And so far, as I said in the, in the comments that's holding in. And then I'm sure we'll talk about this more in the call, but then we balance that with some of the exposure we have across a whole host of markets on the project side. That's more of an indicator for us of overall future confidence where – how people are tilting towards uncertainty, those things. And there's a couple of places where we've seen that slow down. I mean, it's an interesting story overall, where in many ways it's – that kind of businesses just struggle to get traction in this whole recovery cycle.

But other than a few indicators and pockets there, which I think point out a bit further into the future. We sort of keep a look at all of those and then look at our own backlog support on top of all of it. That gives us at least the assurance in the short-term. And, of course, we'll always adjust that and recalibrate it. And that's the joy of the short cycle business. You can do that pretty quick.

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

A

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Yeah. And just to frame that, I mean, our applied guidance, Mike, is kind of a 1 percentage sequential deceleration in Q4. So, it's small, just a little bit of noise that could potentially be out there. But right now, what we have line of sight to and the confidence in our order patterns, we still think the back half is going to be really strong.

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

Q

No. That makes sense. And I think you said the backlog built in the quarter by $39 million, something like that. Is that – are you seeing lead times extend come in? Is that more a reflection of that underlining order strength through the quarter? Maybe just talk a little bit about the backlog piece?

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

A

I mean, it's really broad-based. We're looking at it the other day to see if it was coming in pockets, in chunks, and it's not. I mean, it's kind of layered across a lot of things. Our lead times in aggregate are holding or decelerating. I mean, we made a comment there that we are seeing some pockets where, frankly, our advantaged lead times that are reducing are giving us some opportunity to go grab some share and things. So, I'd say on balance, we're not doing anything to drive that in the wrong direction. It's going in the right direction. And the backlog build is very, very broad-based.

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

Q

Yeah. Last question for me, and you made a comment in there that you invested to support accelerated M&A processes. Is that a reflection of a pretty healthy pipeline? I know the environment has gotten a little more challenging on the M&A side. So, I would like to understand what you're seeing and what you hope those investments could get you?

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

A

Yeah. I'd say – I mean, like I think the environment for high quality assets is held up pretty well as we've gone through this. But a lot of this is very deliberate work on our part to say that, we want to go deeper, frankly into our insight, into those sort of concentric circles that surround our best applications. So, there's a purposeful step-up in work of that type in both resources and some things we're doing with third-party analytics to make sure that we understand it as well as we can in an environment that so far is holding up pretty well for high quality assets.

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

Q

Makes a lot of sense. Thanks. Really appreciate it.

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

A

Thank you, Mike.

Operator: Our next question comes from the line of Deane Dray with RBC Capital Markets. Please proceed with your question.

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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, maybe we can start with the free cash flow guidance cut there. And look, we're seeing this across the sector. This is getting to be pretty familiar. But the idea of carrying more buffer inventory and then the expectation with all this demand likely resulting in higher receivables towards year-end. So, we get the way the math works. But Bill, can you expand on the timeframe for bleeding the inventory down? I guess it really does depend on how the supply chain begins to normalize, but just take us through the math on that?

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

A

Yeah, yeah. No, I think that's exactly right. You know, as we sit here now and lead times as Eric just talked about on our side are improving, we're starting to see that across the broader aspects of our supply chain. So, our increased purchases to buffer some of the longer lead times to continue to deliver for our customers is shrinking. Now, it's just catching up with our production and getting through that – getting that through our system. So, as we look at third quarter, there will be some improvement, but more material decreases in the fourth quarter, leading into the first part of next year. So again, we've spent a lot of time with the teams to understand and calibrate around still having this robust demand, measuring what our vendors and their capabilities are from a lead time perspective and then drawing down our open POs and then increasing the throughput as we have here in the second quarter to the first, and maintaining that as we progress through the back half of the year.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Is there anything on product shortages, semiconductor related where your inventory is, you've got nearly finished goods, but they're waiting on a particular product that's adding to your inventory. Is that an issue at all?

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

A

Yeah. That is a component as we've had customers who – other suppliers for them haven't, then is capable to produce have held up some of their receipts. So, we have finished goods at a higher level than we have had historically because of issues our customers are facing with other suppliers.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Right.

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

A

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And maybe Deane, Deane to the extent you are – I think you're also asking about maybe unfinished things that we have in our own factories or something waiting on a part, much like it's in the auto world. You don't – and I wouldn't say that it's completely devoid of our environments, but you don't see it all that often because we have pretty quick rapid turn one piece flow kind of build. So, it doesn't do well with something that's half done. There's really nowhere to put it. And our production process is quick enough. You're better off not starting it, just because in general, most of our businesses that's how we produce things.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's helpful color there because you do hear like for the autos where they've got all these cars lined up that still need semiconductors and...

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

A

Yeah, we wouldn't put a pump or something into the build schedule because we'll make 40 of them in a couple hours, those kind of things.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Good. All right. Last question for me, Eric, you kind of bagged the question earlier to Mike's when he's asking about the macro where you said there are some pockets of slowing on projects. So, and absolutely, that's a reflection of kind of what we say, CEO confidence, are they going to move ahead. I think you made a reference to midstream and we've heard plenty of that. It just really hasn't realized in and full kind of spending given oil prices. But where and how would you describe some of these pockets of projects slowing or just, you know, not getting the release that you thought you were going to get?

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

A

Yeah. I'd say probably more the second category not getting the release or not coming on the line, something we've been thinking about or projecting for a while now. And some of these just get extended out. So, you mentioned the midstream side. I mean it's in pockets in our chemical markets exposure to be more on the European side than elsewhere. A little bit in the paint dispensing area, we're just kind of coming off the end of a big replenishment cycle there. And then a few things and just specific industrial markets, food expansion, places like that. I mean, they're pretty isolated. It's not a massive part of our business, but they're good indicators, things to watch. And I would just say, been interesting over the cycle here is because this category never really took off. And I think in the beginning it was very much clouded with uncertainty, the nature of the recovery. Then it turned into a kind of a bandwidth issue. Can anybody put together the materials of the time and energy to work on it? Maybe here in the later innings of it, it's sort of all of those factors and uncertainty creeping in back a bit. The bandwidth issue is still there. And now inflation and the cost of these projects is causing some recalibration for – in certain markets for people to have to kind of go back and run the math, again.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's really helpful. Thank you.

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

Thanks, Deane.

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

Hey, guys, good morning.

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

Hi, Allison.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC
Q

Just keeping in mind with that project comment, I know you talked verticals. But is it, I know – like weighted toward a specific geography or is it seem very broad-based type vertical at this point just in terms of what you're seeing?

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

Well, I mean, I think it's broad-based in terms of the way I just described it. I mean, we are seeing a bit more geographic strength in North America than Europe for all the reasons I think we would suspect in terms of things people are watching there on a geopolitical side, the energy side, those things. But both are positive for us. But if I had to call it, I would say a little bit more positive on the North American side than Europe.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC
Q

Great. And then, just kind of going back to the free cash flow and just CapEx in general, tepid start to sort of that – the approach of that $90 million. You talked about Banjo and then investment in emerging markets. I mean, are those still on track or does – you kind of risk that some of that gets pushed to next year just because the uncertainty right now?

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

No, that's what's going to drive the increased spend in the back half. You know, we're expecting both the India and China facilities to open later this year. And then Banjo, I think it's going to – late third quarter, early fourth quarter. So, there's a – those projects I think are on track. Obviously, that's a subset of the $60 million ramp – $30 million ramp, $60 million spend in the back half that relative to supply chain delays and things, we have seen some items smaller and is pushed in the first half and the second. So, there's a little bit of play on that number. But for the large ones, we're confident that those will hit here in the next couple of months.

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Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

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, everybody.

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

A

Hi, Rob.

Rob Wertheimer
Analyst, Melius Research LLC

Q

My question is just a little bit more on M&A. Can you talk about just what the feel is like from potential sellers out there, whether – I don't know whether things get repriced as you kind of edge through different parts of the process and the markets corrected and interest rates are higher. I don't know if there's a standoff as people adjust to different pricing or not and then any comment you make on how big your funnel and comp pipeline are versus prior periods? Thanks.

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

A

Yeah. So, as I said before, I mean, all this is bracketed a bit way by the step up in intentionality and work that we're doing. So, in that respect, again, there's a lot of things we're looking at, a lot of analysis that we're doing, and a lot of conversations that we're having. You would say [indiscernible] (00:28:19) activity level is north of where it has been. Much of it driven by our work. Now, in those conversations, probably much like the conversations you have, there is definitely more discussions around near-term prospects and what's going on with the forecast and how do you see the sales tracking out and to the extent that all links back to valuation. It's just more intense than it has been for all the reasons you suspect. As Bill and I have always said though, when you're looking at assets of the quality that we look at, you're generally looking at a history that's very sharp, well-positioned, driving in strong ways, and then a reasonable projection path, especially if we're the owners that kind of picks that up again. So, it's – that doesn't mean that both sides are going to be able to see that and get through it. So, yeah, that's always a possibility.

But our perspective is very long-term in nature for the kind of assets that we're looking at. So, long story short, more activity on our part, which means, I think, a strong funnel for us, a lot of activity engaging with people, more near-term discussions around what this all means, and where it's going to go. But then, kind of just take a deep breath, stare over the horizon, and be confident that, for quality, I think ideally, both sides see it that way and stay engaged.

Rob Wertheimer
Analyst, Melius Research LLC

Q

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Perfect. Thank you. If I can, I guess, follow up on that on the uncertainty and so forth. You touched on backlog earlier. I don't know if you're willing to give any more color on where your backlog stands versus prior cycles or versus prior record levels, et cetera. It seems there's a bit of a standoff in that everybody is uncertain about the future, but the future doesn't look bad, currently. I don't know if the backlog will help us triangulate that a bit.

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

No, definitely. I mean, our backlog is kind of 2x of what it has been historically. And normally, we'd go into a quarter with 50% of the quarter sales in backlog. We've got close to two-thirds now. So, we have a lot more visibility to temper any dramatic short-term falloff. So, again, relative to the next couple of months, we're fairly confident in our numbers. So, I don't think there's a huge pause that would come because our backlog could support any short-term decrease in orders.

Rob Wertheimer Q
Analyst, Melius Research LLC

Thank you. I'll turn it over. Thanks.

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

Yeah.

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

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

Thanks. Just a couple of quick questions. With respect to price, can you comment on where you were price realization second quarter year-over-year and how much incrementally on top of that you expect to realize in the back half? And then, I have a follow-up.

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

We are a little over 4% here in the second quarter, which ramped from a little over 3% in the first quarter. We don't guide the balance of the year price, but we're really confident in what the teams have gone out with to combat inflation, which seems to have leveled off. So, I mentioned we have an expectation that our price cost is going to continue to improve through the back half of the year to support some of our higher margin profile expectations.

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

In certain areas of the commodity markets, certainly in metals, steel, aluminum, copper, things have come off their highs pretty materially; still elevated from historical standards, but certainly off peak. When does some of that start to actually add some incremental benefit to your P&L?

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

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I would say a couple of things. One relative to – we only have a couple businesses that have direct exposure to commodity prices from a materiality level. We're buying components that are a couple of phases through that value stream. So, obviously, we didn't have the vast inflation impact on the way in that a lot of other companies did. Again, 4% price increase is still price cost positive and we're building. So that'll, I think, wean out over time. There won't be a material impact, but we will keep all the incremental pricing that we've had. Again, we've holistically gone out with price increases versus surcharge. So, we like where we're positioned here going forward.

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

Q

Understood. Thank you very much.

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

A

Sure.

Operator: Our next question comes from the line of Jeff Sprague with Vertical Research. Please proceed with your question.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Hey, thanks. Good morning, everyone. Hey, Eric, can we come back to what you said really on deal cultivation, right, and the activity being more of a function of your internal efforts. Maybe you can elaborate on that. Have you significantly up-resourced the deal teams? Does this heavy level of activity indicate any interest in kind of pursuing new adjacencies? Just a – maybe a little bit of kind of strategic and tactical color...

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

A

Yeah.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

...on what's going on there.

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

A

Yeah. I mean, we're not a massive center-led kind of organization. Never have been. So, this might sound more dramatic than it probably is from a head count perspective. I mean, it's a few well-positioned adds from the outside, some work that we're doing on the third-party side. And then, frankly, the biggest component is just the higher level of engagement overall business to business. I mean, this is something we've been driving now for a couple of years.

And so, we really focus to combine growth outperformance on top of our just sort of institutional grade, well-deserved execution chops. And so, a lot of it's that way.

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In terms of where we're looking and what it looks like, I mean, we've always favored – I always come back to this analogy of concentric circles around these applications that we kind of currently sit in. We know these environments really well. We know what's to the right or left of us. And the best work for me is really starting to understand, where is this market heading? Should we make a move slightly left or right? And how would we do that? The recent acquisitions that we've layered into the company are perfect examples of that.

As we said before, we're also thinking about the broader world, in general, and where problems are presenting themselves and where IDEX-like styles of competition could come in play and maybe that would open up a flank for us and some applications that are new to the company. So, that's in the mix as well.

But if you really had to overgeneralize it and think of it, think of it as just radiating circles from the best parts of the company with more intensity, a lot of it from the ground up. That's the way we like to do it.

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

Yeah. I think those actions, the depth and quality of the funnel is probably at an all-time high. Like that work that the team has done across a variety of different end market applications, those concentric circles that Eric highlighted. And one of the main reasons why we were so confident in our ability to deploy capital much more consistently as we progress.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

Great. And unrelated, just back to this, I mean, everybody's got their ear to the ground trying to sniff out an issue with the economy. Any gut feel that actually these improving lead times are actually the canary in the coal mine? And anything happening in just kind of the supply dynamics when we kind of order the shipment dynamics or anything that maybe are an earlier precursor of some deceleration?

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

That's a good question. I mean, it's hard to say, though, because in many ways we've been running us, others at such a hot level. It's pretty abnormal. Pulling back from that in any way, even if it's just simply the deceleration of the tremendous acceleration we've been feeling is going to have a material noticeable impact inside just how it feels in the business. But I don't know that that's the same thing as a broader call on economic conditions, maybe more than it's just okay, it's not at peak levels. We can catch a breath. We can actually be a little bit more planful, mindful. And that's for us and that's for others as well. So, I think of it more in those terms than let's say, but since there is nothing else to do, we can get product quicker. I don't see it as an indicator of that.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

Great. Appreciate the color. 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

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Good morning, everyone. Thanks for taking my call.

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

A

Hi, Vlad.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

So, I just wanted to ask kind of following up on these macro-related questions. In your businesses that go through distribution, can you give us some color on what you're seeing and hearing in terms of distributor inventories and whether there are any areas where you're more concerned about a potential for destocking in the event of a slowdown?

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

A

Yeah. Well, I always kind of preface this question with a reminder that we have a lot of configured customized products with quick replenishment, which means not a ton of our inventory on shelf. So, it's a small number. I will say, we've got some good visibility to it line of sight, minimum. You can see it visually when you go visit them. And so, you can see some slight increases there for our product. I would assume that's applicable to more stockable components as well. In our world, we think of that as if ultimately that bleeds off over time, in some ways, it's pretty similar to the way that it works in our own business, it takes a while because of the wide variety of SKUs that are out there. None of it's really clumped around a standard solution that if you made a deterministic call on it, which just flow out in a big pocket or chunk. So, we think about it a lot for IDEX mainly just as more of an indicator of health overall, but from a meaningful impact to the numbers up or down, it extends over a large time horizon. It's not a giant piece of the business, and it usually is kind of lost in the math to be honest.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

Okay. That's helpful. And then maybe just stepping back, so you talked about obviously the intent to bleed down some inventory here over the back half and into 2023. But your availability has been, I think, a competitive advantage for you. So, can you talk about what you're seeing in terms of your own supply chain availability and logistics that gives you the confidence to begin to bring down inventory without giving up any of the competitive advantage that you've gained through the recovery?

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

A

Yeah, well, I mean some of it – the impacts are fact based. So, we can see and we track our own, our suppliers' performance and their lead times and their on-time delivery to us. So, you basically start there, and say, what we can see factual lease and improvement, the logistics loops are quite a bit better than where way they have been on the first part of the year. And frankly, our teams are really good now, navigating them when they kind of run astray. I think the biggest thing for us and anybody that wants to go tackle this now is in some ways you got to take advantage of the ability to take a breath. I would say as we've improved throughput, momentum, and we're executing stronger here that does buy us a little bit of time, space and energy to go back and recalibrate the systems, which is what you actually have to do to go attack inventory. You've got to go change demand signals. That's part by part. It's – you do it on lines of paper laid out across the desk. And so, and Bill talks about our engagement with our teams. That's the kind of work we're making sure is happening that people are kind of

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racking and stacking at 80s to 20s and making the calls based on fact-based patterns if they can see and taking advantage of the time and energy they have to go do it.

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

And in some of the areas you've been able to take share, it's because we have an 80 position with that vendor. We're getting a higher allocation in some of our smaller competitors. So, if they don't have the material availability, we're able to go in and take their volume.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.
Q

Perfect. That's really helpful color, guys. Thanks.

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

Just – let's start with a question on Health & Science and the organic order growth that you're seeing there. Everybody is focused on the economy going up and down at the moment, but that's a business that's less cyclical for you and still showing extremely strong orders. Maybe you can just talk in a bit more detail about what's driving those? Are these product cycles that have a specific duration? What the outlook is for continued growth there? Just any more color you can give us on the strength around that business?

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

Yeah. I mean, it's exactly the way you described it. I mean, it's very much tied to strong trends that we're going to, I think, see run out for quite some time here. So, we – like everything else in IDEX, we break it down into all sorts of little components and drivers and specific application sets. And some of the ones that are going well, there the AI space is healthy. That's a decent part of the business. Analytical instrumentation. And then the genomics space has been very, very active. A lot of that is involving initially COVID and COVID surveillance. I think now, as the pandemic has kind of moved on and entering in its third year, we're seeing now some more targeted work around taking some of that technology and applying it for things like targeted medicine and all the things that were always out there for that field of study. So those have been healthy as well.

We continue – we have some isolated pockets where we do support for vaccines and things of that nature. That stayed strong through the duration as they're continuing to work on different targeted vaccines and things like

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that, for both COVID as well as other things. So, it's definitely picking up most of the macro dynamics and trends that we have long known are out there, and that's why we spend a lot of time investing in it and talking about it.

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

Q

Thanks for that. Maybe one on gross margins. I mean you obviously have very strong gross margins for an industrial company to begin with. They've been pretty consistent over the last few years and is 45 plus or minus kind of range. Is there a negative impact that you've seen to gross margins with all of the disruptions around supply chain and COVID that may be are less related to price cost, but modest inefficiencies within your manufacturing that maybe go away, that could lead to higher gross margins or anywhere else that you see opportunities to expand gross margins?

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

A

Yeah. No, I think that the biggest pressure has been price cost. With 45% gross margins, you have to have a price cost spread well in excess of that to expand. So, that has put constant pressure. And then we continue to invest in engineering resources which we remind everyone that is included in our gross margin number. So, we've been able to maintain through robust productivity across the portfolio to offset some of those headwinds. So, I do think price cost getting back to historical levels and then our continued volume leverage that we get on a high contribution margins we have in our business. Once we stabilize a little bit from an operations perspective, we'll be able to pull through some increases with, again, just the very difficult operating environment we've been in, the ability to have discrete productivity projects across the portfolio that we've historically been able to execute on, has been muted a little bit too, here is another point. So, I think as things normalize, we'll get another kicker off of that.

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

Q

Great. Thanks for taking the questions.

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

A

Yeah. Thanks, Nathan.

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

Scott Graham
Analyst, Loop Capital Markets LLC

Q

Thank you for taking the question. Good morning, all, and congratulations on what was a really good quarter from you guys. I have one quick one for Bill, kind of – could you give us an idea of where sort of your sales are running OpEx versus CapEx?

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

A

We don't really disclose that externally, to be honest. We don't look at it internally. It goes a little bit to the project comment that Eric talked about a little bit earlier. It's not a huge part of our business. So, I would say, holistically,

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most of our projects are OpEx, replacing like-for-like, current IDEX volume, and then some incremental market share gains that we have. The CapEx, we have some specific things that we would be able to realize with, you know, plant expansions and new plant creation. But overall, relative to our portfolio, it's not a overly material number. So, the short answer would be holistically, it's more OpEx-related on our sales.

Scott Graham
Analyst, Loop Capital Markets LLC

Q

Got it. Thank you. So, now I want to maybe understand dispensing a little bit. There's a comment in the deck, talks about non-repeat orders, quarter back, maybe two quarters back, you talked about how dispensing should weaken fairly materially in the second half of this year. I'm just trying to triangulate what that means now for the second half of the year. How does dispensing look? Is it – does it look better now or not?

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

A

No. I think it's in line with our expectations that we had at the beginning of the year. I mean orders pressure in the second quarter will add more pressure in the third. But there will continue to have sales growth in the third quarter with sales finally falling off a little bit, kind of, post those replenishment projects in the fourth quarter. So, still a great business, you know, very global, still having wins in emerging markets, the launch of new technologies on the software side. So, although they're going to lose the replenishment, their core business continues to grow. So, it's been cyclical over its life span, but a little bit of pressure here in the short-term as those projects roll-off, but holistically, lots of additional opportunity through software and emerging markets growth.

Scott Graham
Analyst, Loop Capital Markets LLC

Q

Got it. And if I could just squeeze this last one in on the Fire business, where the OEMs, your customers, are they're still saying that they're pretty supply chain-restrained, has anything changed in the last couple of quarters there? Because it's a pretty good business for you guys, particularly now with your – having a nice little beachhead in Europe. Could you give us an idea of where that business goes the next couple quarters?

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

A

Yeah, I'd say that the headlines there, the supply chain constraints on some of the larger folks that are in that space are still there, still challenging, still fighting that. I will say that those kind of smaller to medium specialty players have done a decent job jumping in. So, that's helped us a bit, just not the biggest part of the market.

We remain really, really focused in that business on technology. So, there's only so much we can do to help out on the supply chain side; eventually that will come to a better place. As it does, we want to be ready with all of the automation that we've been talking about. Not only the pieces that we have in the water path of the mobile platform, but we've got a nozzle now that's got connectivity in it and diagnostics. We're doing the same thing on the Rescue tools piece.

So, we got some really, really good things there; just presented in a giant global show here in the second quarter. So, that for us is kind of the longer-term headline on an industry that we think we'll ultimately start to dial in and improve.

Scott Graham
Analyst, Loop Capital Markets LLC

Q

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Got it. Thank you.

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

A

Thanks, Scott.

Operator: Our next question comes from the line of Brett Linzey with Mizuho. Please proceed with your question.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Good morning, all. Hey, just wanted to come back to the orders. So, the underlying run rates in the quarter, very strong, even more encouraging on a two-year stack basis. What is your expectation for year-over-year order growth in the second half as customers are no longer advance ordering or some of this backlog unwinds? I mean, do you think you can grow orders and anything that July would inform you here?

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

A

So obviously, back half, we got much tougher comps in the third quarter, at least relative to what we have visibility. We think we'll still be positive from an organic perspective. Highlighted a little bit the dispensing pressure; that'll continue. But overall, IDEX is still positive. And from a July perspective, no material changes versus the trends that we've experienced here across the portfolio.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Okay, great. And then, just was hoping you could spend a moment on the KZValve acquisition, how that performed on a standalone basis heading into the close relative to expectations. And then, what are you calibrating for accretion within the guidance framework for this year?

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

A

Sure. I'll cover kind of the general state of the business; let Bill answer the financial question. So, I mean, that has been a really, really strong acquisition, strong integration process. It is a very, very close complement to our – in our Banjo franchise in the Ag space within FMT. It's conveniently not very far away. And so, the teams have really attacked it. It's performed strong as all our agricultural businesses have, both in North America and Europe.

And so, this has been, in some ways, one of the easier integrations because the commercial linkage is so strong in the business and everybody's speaking the same – on the same page with technology and the broader market supports it. So, very, very strong out of the gate. Excited on the long-term prospects here. And I'll let Bill talk about the specific...

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

A

Yeah. EPS for the back half's $0.02 to $0.03.

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

Yeah.

Brett Linzey
Analyst, Mizuho Securities USA LLC
Q

Okay. Got it. Thanks for the questions.

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

You bet.

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

Michael Anastasiou
Analyst, Cowen & Co. LLC
Q

Good morning. Congrats on the strong quarter.

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

Thank you.

Michael Anastasiou
Analyst, Cowen & Co. LLC
Q

You mentioned the strength you're seeing more broadly, but obviously, the macro is deteriorating. What types of initiatives are you doing internally to prepare for those macro data points, ultimately, if they start impacting the business?

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

Yeah, no, thanks for that. So, I mean, we've seen a lot of these cycles before. We have kind of a standard way that we look at it. I think, for us, the first lever would be looking at discretionary spend. We've called that out a few times because we came off a base with almost none of it. Now we are out engaging with customers, going to trade shows. So, it's elevated a bit. But we know, frankly, if we learned anything over the last couple of years, you can make it through with a much lower level of discretionary spending. That'd be the first lever.

As Bill mentioned, I think there is an opportunity here for a pretty hard look at productivity across a factory setting. If things were to cool off a bit and we actually got some bandwidth back on the team's perspective, rethought how flow is working, how different product lines are in different positions than where they may have been a couple of years ago. So, we go there next.

The one area that might be a little bit different, we're talking about it a lot, is on the head count side, on the people side. I mean, even today, we still have – we're still looking for people. The war on talent is real. Some of the communities we live and work in, it's been harder to find labor. I mean, that's improved here more recently, but it's

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still – there's still pressure in that area. So, that's probably the area, given all the focus we have on growing the company long-term and that dynamic, we would be the most thoughtful about where we would make choices, investments, and things along the way. Otherwise, I'd say it's a pretty familiar process for us. The short cycle nature helps us get at it fast, and so it's never far away, the playbook to run that. Anything, Bill, you add there?

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

A

No. I think you said it well. It is – [indiscernible] (00:53:10) expectation for decrementals would be a little bit higher than they have been historically because of us – relative recurring profit levels and that war on talent that Eric highlighted. So, maybe we would historically been in the low-30s. We're probably closer to 40% here, if there's a slight hiccup here as we progress over the next couple of quarters.

Michael Anastasiou
Analyst, Cowen & Co. LLC

Q

Thanks. That's really helpful. Just one more, if I may. I know we had mentioned orders before, but declining sequentially over the past quarter. What are you seeing from a [indiscernible] (00:53:50) perspective going forward?

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

A

Yeah. I think there's always – our first quarter, we generally get our annual blankets from a lot of our customers. So, it's generally inflated relative to sequential profile of the balance of the year. So, that's the real driver from the Q1 to Q2. And for us now, it's kind of leveling off with keeping an eye on just our daily order rates, which have sustained here in the month of July.

Michael Anastasiou
Analyst, Cowen & Co. LLC

Q

Great. Thank you.

Operator: There are no further 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, thanks, everybody, for joining today. We're really, really proud of our first half performance here. And as I close, just, I guess, the one thing I'd want you to take away is it's really a story of and, not or, here at IDEX. I mean, we've long, I think, earned our reputation for tactical execution in good times, difficult times. We're seeing that in the performance that we're addressing here today.

And we're working deliberately to drive growth outperformance as an additive component, a value creation on top of it. We basically do that by picking the top bets that align really, really well to the macro trends that are going to be great over the long haul. We rally resources around those.

And then here, as I spoke a few times, we very deliberately complemented those efforts with organic and inorganic investments, and we'll continue to do that as we go forward. So, I think you're seeing it play out. You're seeing it play out, and acquisitions we made that celebrate Precision Ag or alternative energy in the pneumatic

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space or water solutions, and what that can be. So, you're seeing that come together, and I just want to highlight the additive component of those two things, and we'll continue to talk about that as we move forward.

Thanks very much for your interest in joining today.

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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