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# IDEX Corp. (IEX)

Q3 2019 Earnings Call

## CORPORATE PARTICIPANTS

Michael J. Yates

*Chief Accounting Officer & Vice President, IDEX Corp.*

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

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## OTHER PARTICIPANTS

Michael Halloran

*Analyst, Robert W. Baird & Co., Inc.*

Deane Dray

*Analyst, RBC Capital Markets LLC*

Nathan Hardie Jones

*Analyst, Stifel, Nicolaus & Co., Inc.*

Matt J. Summerville

*Analyst, D.A. Davidson & Co.*

Brett Logan Linzey

*Analyst, Vertical Research Partners LLC*

Andrew Buscaglia

*Analyst, Berenberg Capital Markets LLC*

Joseph Giordano

*Analyst, Cowen and Company, LLC*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Greetings and welcome to the IDEX Corporation Third Quarter 2019 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

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

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**Michael J. Yates**

*Chief Accounting Officer & Vice President, IDEX Corp.*

Thank you, Doug. Good morning, everyone. This is Mike Yates, Vice President and Chief Accounting Officer for IDEX Corporation. Let me start by saying thank you for joining us for our discussion of the IDEX third quarter financial highlights. Last night, we issued a press release outlining our company's financial and operating performance for the three months ended September 30, 2019. And later today, we will file our 10-Q. The press release, along with the presentation slides to be used during today's webcast can be accessed on our company's website at [www.idexcorp.com](http://www.idexcorp.com).

Joining me today is Andy Silvernail, our Chairman and CEO, and Bill Grogan, our Chief Financial Officer. The format for our call is as follows: we will begin with Andy providing an overview of our operating performance in the quarter. Bill will then discuss our third quarter financial results and walk you through the operating performance within each of our segments; and finally, Andy will wrap up with an outlook for the fourth quarter and full year 2019. Following our prepared remarks, we'll open the call for your questions.

If you should need to exit the call for any reason, you may access a complete replay beginning approximately two hours after the call concludes by dialing the toll-free number 877-660-6853 and entering conference ID 13684164, or you may simply logon to our company's home page 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' filings with the Securities and Exchange Commission.

With that, I'll now turn this call over to our Chairman and CEO, Andy Silvernail.

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## Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Thanks, Mike. Good morning, everybody. I appreciate you joining us to discuss our 2019 third quarter operating results. In a challenging macro environment, I'm extremely proud of my team. As you know, I've had concerns about the overall demand volatility and the potential for further erosion. We have a short cycle business. We go into any given quarter with only about 50% of the quarter booked. We were prepared, we got ahead of the challenges, and we're executing.

In the quarter, our team delivered outstanding margin expansion, hitting all-time highs for gross margin and operating margin. The healthy margin expansion helped us deliver another record quarter of adjusted EPS and we reduced working capital to drive another record quarter of free cash flow. The results were achieved in a decelerating commercial environment. Organic sales were flat in the quarter. The global demand for industrial products definitely weakened in the third quarter, with manufacturing activity contracting for the first time since 2016, and we're certainly feeling it. Lingering trade tensions and uncertain trade policy have weighed on global growth with customers and business leaders hesitant to spend. This has led to a slowdown in most geographies.

With that said, we remain confident in our ability to thrive in this environment. We're executing the playbook we've spoken about to you all year. We're being prudent about costs and we're focusing on productivity while continue to invest aggressively in our exceptional long-term growth prospects. We've built IDEX to perform throughout the cycle and we're doing the things that make IDEX different. We're investing in great teams who focus on the critical few priorities within our expanding businesses, all of which is in service to our customers. This is what separates IDEX from our competition and allows us to deliver for our customers, employees and shareholders regardless of the macro environment.

We're fortunate that our durable, diversified business model produces exceptional free cash flow and we have an outstanding balance sheet. These facts allow us to have abundant capital to both invest aggressively in organic growth and drive returns through capital deployment.

Let me take a moment to talk about capital deployment before turning over to Bill for some color on the financial results. The integration of Velcora is going extremely well and the teams are delivering on the key value drivers. And as we get inside the business, I'm even more excited about the possibilities that Velcora brings to our Sealing platform.

M&A continues to be a top focus for us, but remains a challenge in the current environment due to valuation. Our teams are hard at work on both the cultivation and evaluation of several deals. With nearly \$2 billion of capacity based on existing cash, availability under our revolver and a very healthy balance sheet, we have the capacity to support the right opportunities, while remaining disciplined within our return framework. We will only move forward

on a deal when the target fits the IDEX criteria. Along with the acquisition of Velcora, we returned \$38 million to shareholders via dividends in the quarter.

With that, let me pause here and, Bill, I'll turn it to you for a discussion of financial results and the segment details.

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## William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

Great. Thanks, Andy. I'll start with our third quarter financial results on slide 4. Q3 orders of \$586 million were down 5%, both overall and organically, driven by softness across all segments of tough comps versus last year. Q3 sales of \$624 million were flat overall and organically. We did see growth in FMT and HST, but it was offset by decline in FSD that was primarily driven by project timing. We expanded gross margins in the quarter by 20 basis points to 45.2%. However, excluding the \$3 million fair value inventory step-up charge related to the Velcora acquisition, adjusted gross margin was at an all-time high of 45.7%, up 70 basis points. This is primarily due to strong price capture and productivity initiatives, partially offset by continued investments in engineering related to new product development.

Q3 operating margin was 22.7% but adjusting for both the fair value inventory step-up and restructuring expenses, adjusted operating margin was 25.2%, an all-time quarterly high for IDEX, and up 120 basis points compared with the adjusted prior-year period, mainly driven by our gross margin expansion and lower SG&A costs which were driven by decreased variable compensation expenses and tighter cost controls across the business. Included in the restructuring charges was an approximate \$10 million impairment charge related to the wind-down of a small business line within HST.

Our Q3 adjusted effective tax rate was 19.1%, which was lower than the 20.3% in the prior-year period, mainly due to changes in US Treasury regulations as well as the mix of global pre-tax income among our jurisdictions. The adjusted ETR of 19.1% was also 340 basis points lower than our previously guided ETR due to a higher excess tax benefit from greater than expected stock option exercises as well as a favorable impact from the 2018 income tax return to provision adjustment. This lower ETR provided \$0.06 of EPS favorability in our quarterly results compared to our previous guide back in July.

Q3 adjusted net income was \$117 million, resulting in a record adjusted EPS of \$1.52, up \$0.11 or 8% over prior year adjusted EPS. Finally, free cash flow was very strong at \$146 million. It was up 28% over last year and 125% of adjusted net income. This was our highest free cash flow of all time.

I'll now turn to the segment discussion, I'm on slide 5, starting with Fluid & Metering. Q3 orders were down 1% overall and flat organically, mainly driven by softening demand in the industrial market and continued declines in agriculture. Q3 sales were up 1% overall and up 2% organically, attributable to the growth in our pumps, valves and energy businesses, due to strong performance around our targeted growth initiatives, but partially offset by the slowdown in the industrial short cycle book and turn activity during the quarter. The municipal water business remains solid with stable spending projected for the remainder of 2019.

In regards to the agriculture market, the market dynamics remain unchanged due to continued tariff pressures and depressed commodity prices, which has put pressure on the Banjo business all year. Pre-season orders are flat compared to prior year period, and we are not forecasting any near-term change to the US agriculture market performance.

Finally, operating margin was outstanding at 32.2%, up 270 basis points over the adjusted prior year quarter, mainly due to a widening price cost spread driven by the team's ability to continually capture value for their products and deliver on their productivity initiatives. FMT really executed during the quarter.

Let's move on to Health & Science, turning to slide 6. Q3 orders were down 4% overall and 6% organically, mainly driven by continued market pressure in semicon and automotive, as well as the industrial slowdown impacting about a third of the sales in HST that are industrially exposed. Orders were also impacted by timing as a few large life science blankets got pushed into the fourth quarter.

From a sales perspective, Q3 sales were up 3% overall and 1% organically, driven by strength in the life science business as they continue to experience growth tied to new product development and collaboration with our key customers. At Gast, we continue to see NPD project wins but as discussed earlier, we started to see challenging market conditions in the third quarter due to weakened North American industrial distribution demand.

For MPT, strong results in Q3 were driven by shipments of some long lead time projects reversing the negative trend we experienced in the first half of the year. We're seeing positive momentum within key pharma markets and our commercial funnel continues to grow. Expectations are to deliver positive growth for the year.

Finally, within sealing, pressure across the semiconductor, industrial and auto markets continue. Although we're beginning to see signals of reaching the bottom of the semi decline, their orders and sales are still challenged. From a margin perspective, excluding the fair value inventory step up charge and restructuring expenses, operating margin increased 30 basis points to 23.8%. This was primarily due to the higher volume and price capture, partially offset by higher growth investments and amortization related to the Velcora acquisition.

I'm now moving to our final segment, Diversified. I'm on slide 7. Q3 orders were down 10% overall and 9% organically, mainly driven by pressure on the project side of the business as customers remain cautious around making large investments, as well as tough comps in dispensing and rescue to large project orders in the prior year period. Both dispensing and rescue orders were down over 20% organically in the quarter. Q3 revenues were down 5% overall and 3% organically and I'll provide a little bit more color on that in a minute.

Adjusted operating margin of 27.2% decreased 50 basis points in the quarter. This was mainly due to the reduced project volume. Sequentially the segment was up 10 basis points versus the second quarter. FSD's performance was mainly driven by the following. On the fire side, core OEM and municipal markets continue to perform well. We're experiencing steady growth across our product offerings, as well as continuing momentum around our new SAM product launch.

Turning to rescue, sales declined mainly due to project delays associated with political uncertainty, coupled with a tough comp from the prior year period. US performance was slowed down due to a delay in FEMA spending but expectations are that we'll see a rebound in the fourth quarter.

Band-IT's performance remained strong based on wins with our targeted growth initiatives. Even as we see general softness in the auto and energy markets and pressure within the industrial space, Band-IT continues to take share and grow in these areas.

Finally, dispensing's story remains similar to the first half of the year due to a tough comp against some large project wins in 2018 with no new projects occurring this year. As such, the business was down double digits compared to prior year but we do expect to cycle back to growth in 2020.

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

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**Andrew K. Silvernail**

*Chairman & Chief Executive Officer, IDEX Corp.*

Thanks, Bill. So, let me wrap things up and I'll provide some details here regarding 2019 for both the fourth quarter and the full year. I'm on the last slide, that's slide 8. In Q4 we're projecting EPS to be in the range of \$1.33 to \$1.35 with flat organic revenue. Operating margin should be about 23.5%. We're estimating about a \$0.01 top line headwind from FX based on the September 30 rates. This translates to about \$0.01 on the bottom line EPS headwind.

Q4 effective tax rate should be about 22% and corporate costs in the fourth quarter will be around \$18 million. If we look at the full year 2019, we're projecting full year EPS of \$5.80 to \$5.82. Full year organic revenue is projected to be about 2%, with operating margins at approximately 24%. We should have about a 2% headwind from FX based on the September 30 rates. The effective tax rate for the year should be about 20.5%. CapEx is anticipated to be about \$55 million and free cash flow should be about 105% of net income. And finally, corporate cost will be about \$73 million for the year. As always, these earnings guidance expectations excludes anything from acquisitions or restructuring.

With that, Doug, let me turn it over to you and we'll open it up for questions.

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## QUESTION AND ANSWER SECTION

**Operator:** Thank you. We will now 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.

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**Michael Halloran**

*Analyst, Robert W. Baird & Co., Inc.*

Hey, morning, everyone.

Q

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**Andrew K. Silvernail**

*Chairman & Chief Executive Officer, IDEX Corp.*

Morning, Mike.

A

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**Michael Halloran**

*Analyst, Robert W. Baird & Co., Inc.*

So, let's start with the underlying trajectory, what you're seeing right now. Lots of puts and takes in the order numbers. FMT is flattish which is typically a more cyclically sensitive business.

Q

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**Andrew K. Silvernail**

*Chairman & Chief Executive Officer, IDEX Corp.*

Yeah.

A

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**Michael Halloran**

*Analyst, Robert W. Baird & Co., Inc.*

Q

And other pieces had some project timing related things. So, maybe you could just talk about what you're seeing is like the core underlying demand characteristics today? What that trajectory looks like to the fourth quarter? And then maybe some puts and takes on how you're looking at growth for 2020.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Sure. So, Mike, first of all, good question. That's the biggest one that's on our mind. You do have to kind of separate out the puts and takes and this is the way I do it. You've got some project timing issues, meaning last year we had an exceptionally strong third quarter, if you look at rescue and dispensing. And those are some pretty good-sized numbers. And then in 2000 and – last year, we got some larger orders, in our life science blanket orders that we typically get that we're going to get in the fourth quarter.

If you take those three things and you neutralize those three things, and you look at the underlying run rate of the business, it's basically flat to down 1%, by about 0.5% if you just kind of look at the underlying day rate businesses. And I think that's pretty consistent with what we've seen. And so, as we get into the fourth quarter, I think you'll see some other puts and takes around there with that day rate business. What we've seen in early October or in October so far is basically kind of meeting our expectations of where we went into the quarter.

And so, I think we're kind of holding at this flattish to down 1% right now on the core order rate of the businesses. So, I don't see a reason for that trajectory right now to change meaningfully as we go out. Now, that being said, we have an easier comp in the fourth quarter versus what you saw last year. And then you've got two pretty tough comps in the first and the second quarter of next year. So, if you assume that you don't get a change in trajectory, I think that that kind of flattish revenue growth in the fourth quarter feels about right. And then you'll face some tougher comps in the first and second quarter with that getting easier in the third and the fourth quarter of next year. That's kind of how we're looking at it.

Look, it's early to call 2020 just based on our short-cycle nature of our business. What I would say is at the first pass that looks like a tougher first half, easier second half, balanced out with somewhere in the range of – I want to say plus 2% to negative 2% but that's what that feels like right now. But again really early on, we're in the process of tightening up our 2020 annual plans but that's what the first pass kind of looks like Mike.

Michael Halloran

*Analyst, Robert W. Baird & Co., Inc.*

Q

No, that makes lot of sense. And then on the margin side, very strong execution this quarter. Walk through any puts and takes you think that might help us on a forward basis to figure out sustainability of this level. Were there anything on the incentive comp that's different, any other kind of one-off things that would move this around one way or another?

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Do you want to talk about those?

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

A

No, – yeah, I think overall obviously with the revised results for the full year there's a decrease in some of the variable compensation stuff. I think fundamentally obviously FMT's margins were really strong. That's where we're going to see probably the most decline is if we are in this industrial softness here recently.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Yeah.

A

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

And they'll delever probably more than the other businesses so that'll put more pressure. I think for the third quarter we guided around 23.5% which is probably what you'd see going forward at a consistent revenue run rate.

A

Michael Halloran

*Analyst, Robert W. Baird & Co., Inc.*

Thanks, guys. Appreciate it.

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

You bet, Mike. Thank you.

A

**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*

Thanks. Good morning, everyone.

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Hey, Deane.

A

Deane Dray

*Analyst, RBC Capital Markets LLC*

Hey. Andy, I appreciate that you made the comment that you were signaling that there was slowing going on. And in fact, you were among the first senior guys back at the EPG Conference in May to say a slowing was happening. So, no one should be blindsided by this but as your orders inflect negatively here, what the – and I know you're short cycle, but you talked about customers hesitating to spend. What's the discussion at the margin right now in terms of committing – willing just to commit capital, the order rates as they look in the fourth quarter? Are we going to stay negative or is it worsening versus the way we started the third quarter?

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

You know I don't see right now, Deane, that it's worsening. But let me kind of back up and talk a little bit about the hesitancy and like you said, we talked about this publicly at EPG. As you look at this, that the issue at hand is that there's just a real hesitancy based on the uncertainty in the marketplace, right. That there is no – there aren't kind of big demand bubbles, meaning negative issues, that things are kind of imploding outside of what I've talked about in the past, these kind of human-made issues that are around the world.

A

But what that's doing is reverberating back and people are just hesitant to spend. They're hesitant to hire. You are seeing more layoffs in the manufacturing sector than we've seen here in quite some time. And so, I think this world of uncertainty unfortunately doesn't – isn't likely to resolve itself anytime soon, right. So you've got the constant back and forth regarding trade tensions that are out there. And the folks who seem to – if anybody knows what's going on – the folks who spend a lot of time on this are very doubtful that any meaningful if positive improvement happens except for maybe a standoff, right. So it just doesn't get worse.

So you've got that. And then really, as you get into the election cycle next year, and you know these are not areas of our expertise, but in terms of talking to people out in the field, people are holding off as long as they can to commit large chunks of money into either hiring or into capital in really uncertain times. So, my view is that it's going to be bumpy here for quite some time.

Deane Dray

*Analyst, RBC Capital Markets LLC*

Q

All right. So the macro commentary is really helpful. But let's pivot now into your end markets and if we just go back to the second quarter when we talked about where the softening was showing up, it was auto, it was semicon, it was ag for you guys and that was like 10% of the portfolio.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yeah.

Deane Dray

*Analyst, RBC Capital Markets LLC*

Q

It really does sound like that's still the kind of ground zero of where you're seeing the slowing. Has that spread to these any other verticals?

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yeah. I think that's the change in the third quarter and if you remember, that was what I said I was concerned about was, you've seen those three continue to struggle. And then you've seen the industrial start to come down, right? So FMT which is you know, two-thirds of our industrial exposure or half our industrial exposure, you can see, although it's still good relative to I think the rest of the world is experiencing, you're definitely seeing that and I expect that to continue here for a little while.

I think that the – let me – the puts and the takes, right, so I think that the negatives are general industrial slowing, and I think we're going to face those headwinds here at least through the second quarter of next year. It's hard to imagine that that's not the case. And then, you've got the question of whether ag, semi, are bottoming. If you look at kind of the auto side, we're probably bottoming in China auto. And then you probably, if you look at the expectations of auto builds, those are down for next year so maybe a little more pressure there. But I do think that net-net, those are still going to struggle for a little while until we see some uptick in semi which by the way we have seen some things that look like a bottom in semi. Ag I think is still a question mark here with the trade tensions and then municipal, sorry, municipal and Health & Science, those are going to hold in.

Deane Dray

*Analyst, RBC Capital Markets LLC*

Q

Yeah. That's exactly what we'd expect and look, you cannot control the slowing on the end markets, but you are obviously doing a great job on margins and cash flow. So congrats on that. Thank you.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Well, thanks Deane. I think the important thing there is controlling our own destiny. We've talked to all of you guys about the playbook, we've looked at in a slowing environment. We're certainly working that. We know how to deal in those environments and make sure that we deliver for our customers, our people and certainly our shareholders. Next question.

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

Nathan Hardie Jones

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Come on, Andy. Control the end markets.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

What you got, Nathan?

Nathan Hardie Jones

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Question on working capital, I mean, it looks like you guys managed inventory really well in the quarter in the face of probably some slower revenue that you are anticipating.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yes.

Nathan Hardie Jones

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Maybe you can talk about whether you need to reduce your inventory levels here in the face of this slower demand environment, whether you can generate some cash over and above what your excellent free cash flow conversion normally is here in this environment?

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yeah. I think Nathan, so first of all, this is something from a business model standpoint we've talked about a lot, that even in times where you're getting pressure on the top line of the business and pressure on margins, that the balance sheet delevers really nicely. And so from a cash EPS perspective, that will hold up well. I expect we'll see more delevering in the fourth quarter and then we'll kind of see where we are in terms of what we're planning for next year. But certainly in the fourth quarter, I expect more delevering.

Nathan Hardie Jones

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

So you're not in any kind of heavy downturn here. You're talking about flat 4Q, kind of plus 2% to minus 2% 2020 outlook. Are there any meaningful cost action plans that you take here? Are there particular businesses where you're seeing worse demand where you think you need to take some cost actions and maybe what those would be?

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yeah. You absolutely do. And to be clear, in this kind of environment and really for IDEX in total, these kinds of things are never broad based, right? We're never – we are not a company that does these kind of wacky 5% reductions across the board. The key to any kind of facing an environment like is, number one, you want to invest in the things that drive long-term sustainable competitive advantage in value. And for us, that really comes down to two big things. The first, our people. And we view people as being central to the business model. It's what scales in this company, and so we're going to continue to invest in the leadership development around the company and making sure that we're very focused on that.

Second, it's really kind of innovation in our core markets. If you think about the 80/20 and the segmentation work that we do around where are the profit pools, how do you continue to make those growth best going forward? And then what you do is you look kind of around that, outside of those core strategic areas and you just have to be prudent. Right, there are places that we're already making targeted cost reductions, but we're going to have to do some more of that if we see some weakening there. And that's just the right thing to do for the long-term competitiveness of the company. And so, we're executing that playbook. We're looking out into the future. As I said, my expectation in this current environment is what you really have in 2020 is a pretty comp in Q1, Q2 and then an easier comp in the back half weighing out to that kind of plus 2% to minus 2%.

Nathan Hardie Jones

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

All right. Thanks for the color, I'll pass it on.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Thanks, Nathan.

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

Matt J. Summerville

*Analyst, D.A. Davidson & Co.*

Q

Thanks. A couple of questions. First, can you maybe give a little bit more geographic granularity in terms of incoming orders and organic performance in the quarter?

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yeah, you bet. Bill, do you want to take those?

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

A

Yes, sure. No, I think it was – Europe has basically maintained its lower level that we've seen over the last couple of quarters. It was really more declines in North America and we started to see the broader order number down. We actually did outperform a bit in some of the emerging markets but again relative to the fundamental macro situations within in India and China, our teams really delivered on their targeted growth initiatives and grew in the upper single digits in those areas.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yeah. So the incremental softening, Matt, it has really been around North America.

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

A

Exactly.

Matt J. Summerville

*Analyst, D.A. Davidson & Co.*

Q

Got it. And then just back maybe to FMT margins, up 270 basis points sequentially. I think – or 270 basis points year-over-year, up 170 basis points sequentially. On a sequential basis that's on lower revenue. So, can you talk about are you pushing more price through that business? Are your input costs coming down meaningfully? Maybe just kind of parse out how you're getting that margin and what the right way to think about FMT margins are kind of going forward at what you're calling kind of a more subdued general industrial environment for that business?

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

A

Yeah, I would say 30% is probably closer to what its normal run rate is. Those businesses even on lower volume are running lights out with the remaining – some projects that they had. And then input costs have decreased. I think the teams, as they looked at where they're getting some pressure from tariffs, they've been able to come up with some supply chain solutions to reduce the impact of those. And the pricing that we put out last year in Q3 to offset some of those just levered better within the quarter.

Matt J. Summerville

*Analyst, D.A. Davidson & Co.*

Q

Got it. That's all for me. Thank you, guys.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Thanks, Matt.

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

Brett Logan Linzey

*Analyst, Vertical Research Partners LLC*

Q

Hi. Good morning, guys.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Good morning, Brett.

A

Brett Logan Linzey

*Analyst, Vertical Research Partners LLC*

Hey. Just wanted to come back to price-cost. Sounds like you've got a very good price traction in the quarter. You do start to lap a tough like-on-like price in Q4 next year. But given the moderating commodities, does price start to flatten out as we get into 2020 or do you still think you can achieve positive price in some of those businesses?

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Brett, we'll get positive pricing in 2020. I feel very confident that the nature of the business model, the nature of our competitive positioning, it'll be lighter than certainly in 2019. There's no doubt about it. But I don't see any reason why we won't sustain that kind of 30 bps to 40 bps price cost leverage that we've gotten in the past. Bill, anything else you'll add to that?

A

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

Yeah. I think the spread as we come into the back half is higher than that. But next year as we calibrate around our 2020 pricing actions, it'll come down a bit. But to Andy's point, I think will still be significantly positive on the price cost differential.

A

Brett Logan Linzey

*Analyst, Vertical Research Partners LLC*

Okay. Great. And then just shifting to the funding delays in rescue, sounds like that gets resolved in Q4. What informs that I guess? And then have you seen any type of funding delays broaden to other agencies as we enter this election cycle?

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Yeah. So, with rescue, in particular, there are kind of two things that you saw. One is just around the world, we've seen this in the past. It's happened many, many times. You get – the sovereign governments who are buying product from us, as things get tight, they can pull back. And so, we're seeing that really wide because we're very close to our customers and we know when money's going to be relieved just generally. So we feel pretty good about that.

A

And then you've got the FEMA issue that Bill referenced. For some reason, and we don't quite understand why FEMA money got tied up here in the third quarter and it feels like it's been released already. There's no reason to believe that that's not going to happen or hasn't happened already.

Brett Logan Linzey

*Analyst, Vertical Research Partners LLC*

Okay. Got it. I'll pass it along. Thanks, guys.

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Thanks.

**Operator:** Our next question comes from the line of Andrew Buscaglia with Berenberg Capital Markets. Please proceed with your question.

Andrew Buscaglia

*Analyst, Berenberg Capital Markets LLC*

Q

Hey, guys. Can you make – can you comment more, you said that you think semis was showing signs of bottoming and that's – can you just remind us first off what – how big is that as a percentage of your sales at this point? And then why do you say that or what are you seeing specifically?

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yeah. So it's not a big chunk.

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

A

About 3%.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

About 3% in total for the business. That the biggest impact there is in our Sealing business and then we have a small pump business that faces that also. And when I say bottoming or inflecting, there's no reason to believe that this thing is picking up dramatically, but we've gotten significant signals from a handful of the big players that they are projecting stronger demand. Now that is mixed with a couple of other things that they see some softening in there.

But we're converting a lot of customers over time, and so a lot of that has been a share gain on top of kind of what's happening to the market. So in other words, Andrew, we're getting direct signals from people on higher demand and to get our supply chains ready. But to be clear, I would not use us as a bellwether for the semiconductor market. We're not the right people to talk to about that.

Andrew Buscaglia

*Analyst, Berenberg Capital Markets LLC*

Q

Got it, okay. And then, I know people are kind of taking up this question a bit, but you grew your sales only about 2% or you'll do about 2% this year.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

Yeah.

Andrew Buscaglia

*Analyst, Berenberg Capital Markets LLC*

Q

And you drove a really impressive incremental margin off of that. It's on the heels of strong incrementals in the prior year. So the question is, how long can you keep this up?

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Yeah.

A

Andrew Buscaglia

*Analyst, Berenberg Capital Markets LLC*

And if you're only, it sounds like you, correct me if I'm wrong, you're implying about 2%, plus or minus in 2020 for the top line. So it just seems unrealistic that expansion is likely.

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Yeah. I think, so, there are a couple of things that really matter there. The first one is the overall top line, when we are, I want to call 2% is kind of the tipping point, right? And 2%, you're covering your inflation, you can still get incremental margins. You get north of 2%, 3%, 4%, you start to really drive those incremental margins in that 30% to 35% range. But 2% is about where you hit parity with just offsetting normal inflation that happens in the business. So overall, kind of that volume number matters.

A

Second, that price cost, what you get between price and costs, if we can keep that 30% to 40%, that will play into that first part, and certainly adds to any kind of expansion that you'd drive for here going out. So look, if we're sub 2% growth rates, it's going to be harder to get any kind of expansion and we'd work to really hold the line is what we'd work to do. And if you get north of 2%, we'll absolutely get expansion just with the normal contribution and the price leverage that we get.

Andrew Buscaglia

*Analyst, Berenberg Capital Markets LLC*

Yeah, okay. And I guess the flip side is you sound like it's unlikely margins will degrade much if anything, so.

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

So let's take the other scenario. So let's say we're down next year, and we've talked about kind of how we thought about that, and I'm going to bore you guys for a second but our overall playbook is looking at what I'll call a vanilla recession looks at kind of 5% down. That's \$125 million of top line coming down. That would be about \$75 million unabated that would hit the bottom line. Our goal would be to offset that by about \$25 million of cost reductions. And so, you can do the math on how that works out.

A

In that kind of environment, we're going to be super thoughtful. I mean, could you go further, could you go deeper, have we done that in the past? We have, but we won't do that. As I've said to you all in the past, if that scenario plays out that I'm talking about, we are going to make sure that we keep reinvesting aggressively in the business. And so that \$25 million range is about what you can do and not have to make other very, very hard tradeoffs. And so, we would make sure that we're super thoughtful. Again, we're investing in those critical priorities around our people and the really attractive businesses we have in terms of innovating in those profit pools. But that's how we're thinking about it in general.

Andrew Buscaglia

*Analyst, Berenberg Capital Markets LLC*

Okay. Yeah, that's really helpful. Thank you.

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

You bet.

A

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

Joseph Giordano

*Analyst, Cowen and Company, LLC*

Hey, guys. Good morning.

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Good morning, Joe.

A

Joseph Giordano

*Analyst, Cowen and Company, LLC*

Hey, and apologies in advance. You might have covered this. I got disconnected for a little bit in the beginning of the Q&A here. But when I look at your CapEx, generally it scales up in the second half of the year. Clearly, you have some markets moving other ways and you're being cautious. But how should we think about that level for the rest of the year and into next year?

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Yes. So, we're going to be at about \$55 million, which is about \$5 million less and that was not our intention. It's a matter of timing and the ability to actually get some stuff in within the fourth quarter, so that \$55 million, \$60 million range, that's a healthy range with our business right now. And I would expect that to be similar going into next year plus or minus.

A

Joseph Giordano

*Analyst, Cowen and Company, LLC*

Okay. And then is your fourth quarter in HST, I know some of it, it seems timing related with the order decline there, but is that like a direct impact into the revenue number that you anticipate for 4Q there?

Q

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

I don't think it's a big, big impact. It's just – that timing of that order, those things are blankets that are going to be in the future.

A

Joseph Giordano

*Analyst, Cowen and Company, LLC*

Q

Right. Okay.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

So, I don't think that'd be a real impact to the fourth quarter.

William K. Grogan

*Chief Financial Officer & Senior Vice President, IDEX Corp.*

A

Yeah. I mean OEMs, when they place here, we've had some volatility between Q3, Q4 and Q1 that have created some noise in the comps there.

Joseph Giordano

*Analyst, Cowen and Company, LLC*

Q

Okay. And then if I can just clarify something, Andy. I think in your downside analysis that you just ran through on a 5% decline, did you say \$75 million would come off like unabated to the bottom line on \$125 million declined? Did I just hear that?

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

I'm just using the – if you do nothing, right, and effectively it flows through at what we call material margin, right, so material contribution or value added, that's what it would be if you did nothing, right.

Joseph Giordano

*Analyst, Cowen and Company, LLC*

Q

Okay. So, 60% or something like that.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

There a percent of the future margins of the company.

Joseph Giordano

*Analyst, Cowen and Company, LLC*

Q

Okay. Thanks.

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

A

You bet.

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

Andrew K. Silvernail

*Chairman & Chief Executive Officer, IDEX Corp.*

Well, thank you very much, Doug, I appreciate it. And thank you, all, for your time and attention here on our call. Again in this kind of volatile environment that we've all been living in, I could not be more proud of the team in

terms of how they have executed and delivered really for our customers first and then for our people and also for you, our shareholders. So we're thrilled about that. We appreciate the support that we get from the investment community. And with that we will say goodbye and talk to you here again in 90 days. Take care.

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**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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