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IDEX Corp. (IEX)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to IDEX Corporation's Fourth Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to turn the conference over to your host, Mike Yates. Thank you. You may begin.

Michael J. Yates

Chief Accounting Officer & Vice President, IDEX Corp.

Thank you, Rob. 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 fourth quarter and full-year 2019 financial highlights. Last night, we issued a press release outlining our company's financial and operating performance for the three months and the year ending December 31, 2019. The press release, along with the presentation slides to be used during today's webcast, can be accessed on our company's website at www.idexcorp.com.

Joining me today is Andy Silvernail, our Chairman and CEO, and Bill Grogan, our Chief Financial Officer. The format for our call is as follows: we will begin with Andy providing an overview of operating performance in the

quarter and for the full year. Bill then will walk you through the fourth quarter and full year 2019 financial results and the operating performance within each of our segments; and finally, Andy will wrap up with an outlook for the first quarter and the full year 2020. 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 the complete replay beginning approximately two hours after the call concludes by dialing the toll-free number 877-660-6853 and entering conference ID number 13694803 or you may simply log on to the company's home page for a webcast replay.

Before we begin, a brief reminder that 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 the call over to our Chairman and CEO Andy Silvernail.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Thanks Mike. Hey, good morning, everyone. I appreciate you joining us to discuss our 2019 fourth quarter and full year operating results. 2019 was another record year for IDEX. We hit all-time highs on most of our key metrics. We continue to grow organically through our targeted growth initiatives and our ability to capture value through strategic pricing.

We expanded margins by leveraging our top line and we executed well on our productivity funnel. Our efforts resulted in records in sales, margin, earnings, free cash flow, and return on invested capital. We built IDEX to outperform over a cycle, and we're doing the things to make IDEX different. We're investing in great teams who focus on the critical few priorities within our outstanding 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.

We've been candid in our view of the weakening global economy. This continued in Q4 and we believe it will for the next quarter or two. While the Phase one trade deal was signed, customers up and down the supply chain remain hesitant to spend in the face of uncertainty. Additionally, in 2020, we will have three very successful multiyear growth initiatives worth \$30 million that aren't repeating.

Our funnel of growth initiatives is strong, but we'll face additional headwinds especially in the first half. Understanding the challenging environment, we proactively executed on the playbook we previously discussed with you. We want to ensure that we're well-positioned to perform and invest for long-term profitable growth. To that end, we executed a restructuring in the fourth quarter that would result in \$15 million of savings in 2020.

The current environment is challenging, but we'll control our own destiny through focus and execution. I'm confident in our capabilities, the strength of our diversified portfolio and the quality of our teams are fully demonstrated in these times. Our proactive cost reductions, along with a strong balance sheet, put us in a great position to continue to deliver long-term value for our shareholders during volatile times. We have the team, the strategy and the capital available to perform and to take advantage of opportunities as they present themselves.

One such opportunity is the Flow MD acquisition we announced last night. Flow Management Devices is a leading provider of small volume provers used to ensure flow accuracy in the critical applications in the oil and gas industry. FMD has annual sales of approximately \$60 million and EBITDA margins of about 20%. We think their innovative technology will provide above-market growth and that this will complement our ability to execute

on operational efficiencies. We believe there are at least 500 basis points of margin expansion opportunities and we're excited to have them as part of the IDEX family. The rest of our M&A pipeline is solid and we continue to actively assess several opportunities. With nearly \$2 billion of capital available, we'll aggressively pursue the right opportunities, while remaining disciplined within our return framework.

As for the other tenets of capital deployment, while CapEx was down slightly compared to last year, much of the decline was due to timing of a few projects moving into 2020. We continued to invest aggressively in opportunities to stimulate organic growth and drive margin expansion. We will also continue to focus on returning value to our shareholders. In 2019, we returned \$147 million to shareholders via dividends, a 16% increase over last year, and we bought back \$55 million of stock at an average price of \$140.52. We remain focused on our capital deployment strategy, a significant source of value creation.

I'm going to pause here; I'm going to turn it over to Bill who is going to talk about the financial results and the segment discussion.

William K. Grogan

Chief Financial Officer & Senior Vice President, IDEX Corp.

Thanks, Andy. I'll start with our consolidated financial results on slide 4. Q4 orders of \$617 million were up 1% overall and flat organically. I'll get into more detail through the segment discussions. However, at a high level, the slowdown in our industrial end markets negatively impacted a significant portion of our portfolio. This was offset by positive momentum in our life sciences, fire and rescue and pharma businesses.

For the year, orders were flat both overall and organically, with strong organic orders in the first half of the year, offset by the slowdown we experienced in the back half. Q4 sales of \$606 million were down 1% overall and down 2% organically. Industrial market softness and the runoff in targeted growth initiatives negatively impacted us in the fourth quarter.

Full year sales of \$2.5 billion were flat overall and up 1% organically, driven by price and strong target growth performance in several businesses, offset by short-cycle industrial volume declines and the softness we saw in semi, auto and ag throughout the year.

Q4 gross margins contracted 60 basis points to 44% in the quarter, driven by a decline in volume and unfavorable sales mix. For the year, full gross margins expanded 10 basis points. However, excluding the impact of the third quarter Velcora inventory step-up, adjusted gross margins expanded 20 basis points to 45.2%, driven by price and productivity, more than offsetting the volume and mix pressure, and our continued investments in engineering.

Q4 operating margin was 22.1% and full year margin was 23.2%. Adjusting for restructuring expenses and the fair value step-up in Q3, adjusted operating margin was 23.3% in the fourth quarter and 24.2% for the year. The 23.3% Q4 margin was flat to 2018 and the full year 24.2% increased 80 basis points compared with the adjusted prior year, mainly driven by our gross margin expansion and lower SG&A costs from decreased variable compensation expenses and overall tighter cost controls.

Our Q4 effective tax rate was 20.6%, which was lower than the 23.8% in the prior-year period due to certain onetime charges related to tax reform incurred in the fourth quarter of 2018 and several small discrete tax benefits in 2019. For the year, our effective tax rate also benefited from discrete items we realized in 2019 associated with equity vesting and option exercising.

Q4 adjusted net income was \$102 million, resulting in an adjusted EPS of \$1.33, up \$0.02 or 2% over prior year adjusted EPS. Full year adjusted net income was \$444 million, resulting in adjusted EPS of \$5.80, up \$0.39 or 7% compared to prior year.

Finally, free cash flow was \$137 million, flat compared to prior year, but was 134% of adjusted net income. For the year, free cash flow was \$477 million, a record for IDEX, up 13% versus last year and was 100% – 107% of adjusted net income.

I'll now turn to the segment discussion. I'm on slide 5, starting with Fluid & Metering. Q4 orders were down 5% overall and down 4% organically, mainly driven by softening demand in the industrial market and continued declines in agriculture. Full-year orders were flat overall, but up 2% organically due to chemical market strength and targeted growth wins, more than offsetting weaker industrial and ag performance.

Q4 sales were down 4% overall and down 3% organically, driven by the industrial market softness and runoff of targeted growth initiatives. Full-year sales were up 1% overall and 2% organically due to the strong targeted growth performance in the first three quarters of the year, along with strong chemical market and stable municipal and energy markets, again, more than offsetting the industrial and ag softness we experienced.

In regards to our agriculture market, the market dynamics remain unchanged due to continued tariff pressures and depressed commodity prices, which put pressure on our Banjo business. While there is cautious optimism from the Phase One trade deal, we are not forecasting any near-term change to the US ag market. OEM forecasts have improved, but are still negative.

As it relates to the industrial space, in December, we saw US industrial production post the lowest results in a decade. The contraction in the European markets we have seen over the last few quarters continued, and we see this pressure in both North America and Europe carrying into 2020.

Finally, adjusted operating margin. For the quarter, it was 28%, down 110 basis points compared to the prior year, driven by volume declines and sales mix, along with startup costs associated with the new plant opening within our energy platform. Full-year adjusted operating margin was 30.1%, an increase of 90 basis points year-over-year, mainly driven by price capture and delivering on productivity initiatives across the segment.

Let's move on to Health Science, turning to slide 6. Q4 orders were up 6% overall and 3% organically, driven by our life science OEMs and strength at MPT. Full-year orders were flat overall and down 1% organically due to soft semiconductor, auto and industrial markets, offset by positive performance in life sciences and pharma markets.

From a sales perspective, Q4 sales were up 1% overall and down 3% organically. Full-year sales were up 2% overall and 1% organically, driven by strength in our life sciences business, for the quarter and full year, as they continue to experience growth tied to new product development and collaboration with key customers.

On a comparable basis, life sciences grew 6% for the year. At Gast, we continue to see challenging market conditions in the fourth quarter due to weakened North American and European industrial distribution, coupled with the runoff of targeted growth initiatives that began in 2018 and ended in Q3 of this year. For the full year, Gast was up organically due to strong performance with that initiative.

For MPT, strong order performance continued in Q4 as we continued momentum within our key pharma markets. MPT's backlog puts them in a great position for the first half of 2020. Finally, within Sealing, we saw pressure in

the industrial and oil and gas markets, but some growth in semicon late in the quarter and are cautiously optimistic for that to continue into 2020.

From a margin perspective, excluding restructuring expenses, fourth quarter adjusted operating margin decreased 60 basis points to 22.8%. This was primarily due to the volume decline in engineering investments in the business. Full year adjusted operating margin increased 20 basis points to 23.8% due to price and cost control efforts.

I'm now moving to our final segment, Diversified. I'm on slide 7. Q4 orders were up 1% overall and 2% organically. Full year orders were down 2% overall and flat organically, mostly due to the project nature of dispensing. Q4 sales were flat, but up 1% organically. Full year sales were down 2% and flat organically as well, primarily driven by an 11% decrease at dispensing. The balance of the segment was up low-single digits for the year. Adjusting operating margin of 26.2% decreased 30 basis points in the quarter. For the full year, adjusted operating margin of 26.6% was down 20 basis points, primarily due to sales mix with dispensing.

FSD's performance was mainly driven by the – on the fire side, North American OEM and municipal markets continue to perform well. We're experiencing steady growth across our offerings as well as continued momentum around the new SAM product. In rescue, we saw a bounce back in Q4 with the release of FEMA spending we discussed last quarter, as well as high demand for the new watertight tool they launched earlier in the year.

Band-IT's performance moderated in the quarter with relative strength in transportation being offset by softness in the industrial and oil and gas markets.

Finally, dispensing story continue with tough comps against project wins in 2019 and a lack of new projects occurring this year. For 2020, we do not see a recovery now and expect dispensing to be flat for the year.

I'll now pass it back to Andy to provide an update on our 2020 guidance.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Thanks, Bill. Hey, everybody. I'm on slide 8. So on an operational basis, as we look at the year, we expect market headwinds to persist in the first half. And overall for the year, we expect organic revenue to be flat to down 2%. We expect this to translate to EPS being up \$0.09 to possibly being down \$0.30, depending upon the top line results. We have price capture of about 80 basis points baked into the guide. We expect our productivity initiatives to more than offset inflation, providing \$0.02 of benefit. And as I mentioned earlier, our focus continues to be to invest in organic opportunities. These growth investments will be about a \$0.04 headwind in 2020.

As I mentioned, the cost actions that we took in the fourth quarter, this will result in a \$0.15 of benefit. Additionally, we can get up to \$0.20 if market conditions worsen. We anticipate a \$0.06 to \$0.10 headwind from variable compensation as we reset our incentive account for 2020. We expect our Velcora acquisition will provide 1% of growth on the top line and \$0.03 of benefits to EPS.

As we look at some of the non-operational items, FX and share count should offset and we expect a \$0.10 headwind from tax, primarily related to discrete benefits we got from associated with the equity vesting and options exercising. So in summary, we're projecting revenue to be flat to down 2% in 2020 and EPS to be in the range of \$5.55 to \$5.85.

Before we wrap things up, I'll provide some additional details regarding our 2020 guidance for both the first quarter and the full year. I'm on the last slide, that's slide 9. In Q1, we expect EPS to be in the range of \$1.30 to \$1.34, with market headwinds contributing to 4% to 5% organic revenue decline and operating margins of about 23%.

We don't expect any significant impact from FX; we expect the corporate tax rate to be about 20% and Q1 corporate cost to be about \$20 million. If you look at the full-year 2020, again, we expect EPS to be \$5.55 to \$5.85, full year revenue is projected to be flat to down 2% and op margins should be somewhere between 23.8% and 24.5%. We don't expect FX to have a significant impact and for the year, we expect tax to be at about 22%.

CapEx is anticipated to be about \$55 million and free cash flow should be around 105% to 110% of net income and finally, corporate costs should be around \$75 million for the year. As always, our earnings guidance excludes any costs associated with future acquisitions or future restructuring.

With that, Rob, let me turn it over to you and we'll take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Mike Halloran with Baird. Please proceed with your question.

Michael Patrick Halloran

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

Q

Hey. Good morning, everyone.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Good morning, Mike. How are you?

Michael Patrick Halloran

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

Q

I'm all good. I'm all good. So, could you help understand the dynamic as you're seeing it today, when you look at the back half of the year orders down 5% or so in the third, flattish in the fourth, the first quarter guide implies something worse than that trajectory maybe implies. Now, maybe comps are part of the variability there. But talk about what you're seeing in the short term that kind of leads to that decline, if you're still seeing some deceleration in the market and customer psyche as you see it today?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah, Mike. So, from where we are right now, we don't see the industrial markets in particular getting worse. There's no indication that it's getting worse. You've got a couple – and I think – and that's – I think that's probably the most important thing is that you saw the deceleration in the fourth quarter, particularly towards the end of the year of the industrials. That was the biggest negative for us in the fourth quarter and actually really in the back half of all of last year. We've been doing our annual planning. We finally finished up what we call our true-up just recently.

And from what we can see, we're not seeing a further deceleration in industrials. So the question comes up, well, how does that turn into a negative 4% or negative 5%? And there are really a few pieces to that. The first is you're right, it's a tough comp. We had a pretty strong first quarter of last year. Second, the overall order rate in the fourth quarter is a little bit masked by the fact that we had real strength in HST. And so if you remember in the third quarter, we said that we felt like there was a blanket that usually lands somewhere between the third, fourth or the first quarter; it came in the fourth quarter. So, if you kind – if you separate out from that, orders are a little bit weaker overall and of course that sale is going to happen kind of later in this year, possibly even bleeding over to the first quarter of next year. So you got comps, you've got that and you've got just the general industrial softness that we see generally bottoming right now.

Michael Patrick Halloran

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

Q

Makes sense. And then when you think about the guidance for the full year, what sort of an environment's embedded in them? In other words, is there any improvement assumed in the underlying fundamentals or is it relative stability sequentially? And then secondarily and related, what are you guys looking for to get a little bit more confidence that your customer base is going to be willing to put more CapEx dollars to work? I'm assuming you look at a lot of the same quantitative things, but anything qualitative on that side would be helpful.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah, Mike. So, I think if you take our top line guide of 0% to down 2% and if you remember when we were at the Baird Conference, we bracketed it around plus 2% to negative 2%, right? So that's kind of been our view for a while, so we're now at kind of 0% to negative 2%. So, let me talk about what I think would have to happen to land at one end or the other. So to land at 0%, you'd have to have a modest improvement, I mean very modest improvement in the second half of the year.

So we're expecting the first half to be weak with all the stuff I just talked about and a very modest improvement. Part of that is we're going to have that larger life science sale happening in the back half of the year, which is a positive and then a very, very modest improvement coming up against much easier comps in the second half. So there's no hockey stick. There's no aggressive improvement assumed. It's pretty dang modest to get to the 0%. The negative 2% assumes that what we are experiencing in the fourth quarter continues the entire year. So if you kind of look – if you flat line from here, that's the negative 2%.

Michael Patrick Halloran

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

Q

Appreciate it. Thank you, Andy.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. No problem, Mike.

Operator: Our next question comes from Allison Poliniak with Wells Fargo. Please proceed with your question.

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities LLC

Q

Hi, guys. Good morning.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Hi, Allison.

A

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities LLC

Just want to go back to your comment about the targeted growth initiatives rolling off. It doesn't sound like there's stuff behind it, but I assume there is. Just...

Q

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Yeah.

A

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities LLC

...is it just the market? Can you just sort of walk us through that a little bit?

Q

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Yes. So, if you went back to kind of 2018 or so and when we were blowing the doors off of growth, and we said, hey, we can get – we can talk discretely about where that's coming from. That's what we call targeted growth. So – and what was happening was we were winning above where we thought we would win, plus things being sticking and kind of building into the run rate.

A

And so, what we're seeing right now is we had three of those initiatives; two that are in HST, and one in FMT that are, frankly, as the market is softening, we're not seeing that happen again. And one of them is very much discrete relative to going into a more consumer-facing business. So that's kind of the \$30 million headwind. To your point, we have – in any year, we're tracking about 25 discrete growth initiatives at the corporate level that are worth anywhere from, call it, \$50 million to \$100 million. That's the kind of the range that you're looking at.

And for us, to hit our stated goal of trying to be 2% above our core market, you got to win about half of those. And so I'm not worried about what we're winning this year. I actually feel very good about what we're winning. We just have a bigger hole than we historically have had and that's that \$30 million.

William K. Grogan

Chief Financial Officer & Senior Vice President, IDEX Corp.

I think the thing to add too is some of those projects are just taking a little bit longer to materialize with the end market. So as the end products are going to be really launched by customers, those have just been delayed a little bit.

A

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Yeah. That's a good point, Bill. You do see kind of uptake or market acceptance be slower and softer in market conditions like this.

A

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities LLC

Q

Great. That's helpful. And then just turning to the acquisition, it seems like a good fit for IDEX. What does it bring to the table that maybe you didn't have or you couldn't do yourself?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So we definitely could not have done this ourselves. It's – so if you think of custody transfer, we're in the custody transfer business already, but it's in a different market segment in oil and gas. And this is kind of a perfect IDEX product where we're going into the custody transfer market with a very distinctive niche technology that some of the bigger players and larger applications don't have in the market and would be tough to develop and it has some intellectual property associated with it. So it's an adjacency to our custody transfer business. It's an adjacency to our LACT business. And it kind of gives us a classic IDEX-like wonderful, innovative technology that's in a faster, growing overall segment than the marketplace and terrific positioning with good competitive moats.

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities LLC

Q

Perfect. Thank you.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Thanks, Allison.

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

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Hey. Good morning.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Hey, Scott.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

So just – first one is a sort of a 40,000 foot question if I look at the – on a full year basis, your organic was up a point.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

And I know your pricing was probably landed in the 1% to 2% territory suggesting that, on a full year basis, volumes were flat, maybe even slightly down. And I just – we can certainly triangulate where that came from, but what's the plan there? I know that it's not the goal, even when you talk about the fixed businesses, to have a potential negative volume. What are you thinking there, Andy?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So it really – it's the entire – it's the marketplace, right? So, if you look at industrial production and we obviously – we track pretty closely to industrial production in terms of our market. If you were to track IDEX's organic growth relative to industrial production over a long period of time, what you'd see is you'd see, when industrial production inflects one way or the other, up or down, we tend to be slightly exaggerated in both cases, right? So when industrial production inflects down, we tend to be a little bit worse – our markets tend to be a little bit worse than that and when it inflects up, we tend to be better than that.

When it's relatively stable, our markets track to it pretty closely. So if you're going to think of it as a graph, that's what that would look like. And what we're experiencing right now, Scott, is that inflection downward, right. So if you look at the ISM, you look at industrial production overall, that's what we've been seeing here. And if you remember back this time last year, we were calling that. We said, look, that's what it looks like it's going to play out to us and it is what's played out, and that's why we've been preparing, really, for the balance of this year to execute a restructuring if we needed to.

And so, when you really simplify it, that's what's going on in the world. I feel really good about how we're executing and what we're doing relative to those markets. I like our positioning. I like our ability to get price. Our overall moats around our business and competitive advantage are highly durable. So it's just a function of the markets.

William K. Grogan

Chief Financial Officer & Senior Vice President, IDEX Corp.

A

Scott, I think the other thing I'd add is, obviously, dispensing had some significant pressure this year, being down almost \$15 million. That contributed to some of that volume decline, along with some of the very specific things we had within semicon and ag that put probably close to another \$20 million of pressure on this year's volume.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Understood. Thank you. Those are great answers. I really appreciate that. The...

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

No problem.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

...other question I had for you is on your bridge here where – I think it's a tougher question to ask, of course, but could you explain a little bit more on the variable compensation, why that's a negative for 2020 given the guidance? Maybe explain...

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So, I mean, it's actually pretty straightforward. When you don't hit your goals, your comp comes down for the company, and then it basically kind of resets as you go into the year. So you've got that headwind between the two.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Okay. Nothing more than that? No – there's not like something that's new as part of a comp plan or anything like that?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Oh, no, no, no. We're pretty Steady-Eddie...

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Okay.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

...around that stuff.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Great. And if you don't mind, I'd love to sneak in one more here. Could you tell us what exactly pricing was in the quarter? And you've always been able to do this – or last several years, at least, this 30, 40-basis-point spread versus some...

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

...materials inflation. Do you expect to be able to maintain that next year? But also, of course, what was pricing this quarter?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So very consistent with the year; so, it's just north of a point. And we did – for the year, we did a little bit better than that 30 basis points to 40 basis points. We were – we had very strong productivity execution and

inflation came in a little bit lower than we thought. It was actually pretty hot coming into last year. And so, it was a little bit better than our normal 30 basis points to 40 basis points.

As you look at this year, we've got – as I said in my remarks, we've got about 80 basis points built into the guide right now with that same 30 basis points to 40 basis points spread. So we expect – as we look at the world right now, given the softness for us and the entire supply chain, we expect inflation to be pretty low. And overall, we actually expect to more than offset inflation with our normal productivity.

Scott Graham

Analyst, Rosenblatt Securities, Inc.

Q

Got it. Thank you very much. Appreciate it.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Thanks, Scott.

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

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good morning, everyone.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Hey, Nathan.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Just a follow-up to Allison's questions on the growth investments and the headwinds there. Talking about a \$30 million headwind in 2020, can you talk a little bit more about that headwind? Are these – were these sales that are onetime in nature and go away, they don't build into the base and continue on that gets you to a \$30 million headwind for this year?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

So you actually got two different things that you're talking about, Nathan. So I'm going to separate them and, hopefully, I'll clarify. So the investments that are going into this year, we go into any year deciding on incremental investments. So you've got an ongoing level of investment that happens in the company around growth. And then, depending upon the opportunities in front of us, we decide whether or not we're going to put the kind of incremental above-normal investments into some growth initiatives. And that's what that headwind is that we talked about, that \$0.04 headwind that we talked about. And the way to think about this is none of this – none of the investment that we're going to make in 2020 is going to do anything for us in 2020, right? It's for future growth. And that's just the nature of our markets. So that's kind of the one side of it which is we're going to continue investing in our growth opportunities to help us outgrow our competitive marketplaces. And that's what that incremental investment is. The \$30 million that you're referring to, those are really things that have been in play

for a very long time, right, so the benefits that we've gotten over the years, you're talking about stuff that's been in play five, six, seven years in many cases.

And what's happening is they are – they're coming to a natural end more abruptly than we would normally see in our marketplace. Some of it has to do, some of it is, for instance, is in the LACT business where the sensitivity to what's going on in oil and gas, overall spending is down. So the uptake is there, but to be clear, that still – that's gone from \$0 to \$30 million business for us in the last, what three years, Bill? So it's still a very nice business. It's just going to be down versus last year.

Another is on the gas side where we really took wonderful advantage of a market opportunity where we had developed a unique technology where they built out a huge number of venues very, very quickly. And so we'll still get parts and service revenue from that, but that kind of two-year really aggressive build-out won't replicate itself. We'll do it in other places in the market, but it's going to be – it's just not going to be the same size that it was in 2019-2018.

So it's pretty unique for us to kind of have all those tailwinds all at the same time and we're kind of facing a little bit of that in 2020 as we go forward. But if you just kind of step back from all of this and you, say is our strategy of investing for above-market growth working? The way I think of it is, if you think about the last three years in total, so 2017, 2018, 2019, we've had organic growth that's averaged about 5% when you look at all those. With industrial production, I want to say around 2.4% or so and so we're basically double industrial production. We're beating that 200 basis points that we've set as a target. It's not going to happen every single year, but over a three-year period, boy, it should happen and it has happened.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. That makes sense. And my follow-up question is on the – call it, the restructuring that you did in the fourth quarter, taking out \$15 million of cost. For a midpoint of down 1% organically, that's a bit more aggressive than I would have expected from you guys. I know you've always said it's easy to ramp the business up than to ramp it down. So, is this kind of – you've taken cost out. If things are a bit worse than you anticipate in 2020, you've already kind of addressed that...

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah...

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

...that cost there?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

You've got it exactly right, Nathan. When – these are painful. They're traumatic to businesses and we don't like to be in the business of pressing this button. And so, if you have to press it, you press it once. And our intention, we've got about another \$5 million of more variable stuff that's not people-related that we can address if things get softer from here. That's why it goes up to \$20 million in the down 2% scenario. But a big piece of who we are as a company, a big piece of our culture is that we don't engage in these never-ending restructurings that cause uncertainty.

A big piece of our value proposition to the marketplace for people is that this is a company that grows. This is a company that invests in people. And our culture is a huge piece of who we are in terms of our identity. And so, we do this with real trepidation and you do it one time if you can.

Nathan Hardie Jones

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. That makes sense. Thanks very much for the time. I'll pass it on.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Thanks, Nathan.

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

Matt J. Summerville

Analyst, D. A. Davidson & Co.

Q

Thanks. Just a question on HST first. Can you maybe talk about what kind of organic growth rates you think you'll experience in life science and the pharma business in 2019 or excuse me in 2020? And then conversely, how much contraction you've built into that industrial side of the business.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So I think, generally, you're looking at 5% to 6%, Matt. If you look at the combination of what we would call IDEX Health & Science, LLC, which is life science and MPT which is principally going into pharma and food. So I think with those two combined, you're looking at, call it, 5-ish percent, maybe a little bit better if you can get to 6%, which I have to back into the math. Bill, do you know what the math [indiscernible] (36:09) down – for the other stuff if we went down from 3%. Is that what that would count to?

William K. Grogan

Chief Financial Officer & Senior Vice President, IDEX Corp.

A

Yeah. About...

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. About – I want to say down about 3%, Matt. That's more kind of industrial-facing.

Matt J. Summerville

Analyst, D. A. Davidson & Co.

Q

Got it. Thank you. And then you mentioned, I think, in your prepared remarks beyond Flow MD that you do indeed have other things in the pipeline. Can you sort of talk about relative size, magnitude of maybe actual actionability on those deals and maybe the end markets you're targeting?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So it's really – it's not a lot different. The funnel doesn't look a lot different than it's looked for quite a long time. We've got a few things that are decent size, I won't say just big, but are decent size that we're working on and it's hard to say actionability, right? Two in particular that we're working on, they are both auctions. As you know, we have an incredibly disciplined methodology that we go about in terms of our ability to get to returns. And if we're able to make that happen, then that would be exciting. At the same time, the discipline of our return framework is important and we're not going to break that.

Matt J. Summerville

Analyst, D. A. Davidson & Co.

Q

Got it. Thank you, guys.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Thank you.

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

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning, everyone.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Hey, Deane. Good morning.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Hey. Andy, was hoping you could comment on where you see things playing out in China with the coronavirus business disruptions. Are you baking anything in today's guidance for 2020 on what's going on there?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

So, Deane, as you know, it's a pretty fluid situation. There's a lot going on. What we've done so far is we have paused travel to and from China, and then of course everything within China, we're following the guidelines of what's happening there in terms of people, people movement, and just overall what's happening with the Lunar New Year. We're just – we're sticking to the policy that's out there.

Because China isn't a big piece of our business, right, it's – what's it now, 6%, Bill, 5%, 6%? I don't expect it to be material, and we don't have a huge supply chain coming directly from China or into China. That being said, we will – we'll face what everybody else faces if this gets really, really significant and all of a sudden we see this grow and spread across the globe. But I don't expect it to be material in a differentiated way for us.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

That's helpful. And I also appreciate the first thing you led with was you've restricted travel because it's your employees' safety that matters most here. So appreciate that. And then what more – let's just say things do deteriorate further...

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

...and you are loath to do restructuring, what are kind of the trigger points for you? Because we've talked about the playbook here and...

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

...this got discussed earlier. But what is it decrementals, where and how do you surgically make decisions if things were to worsen?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So, if you remember what we've talked about for quite some time is we've looked at kind of a down \$5 million scenario and I won't walk through all the math again. But if you recall kind of how we work through that was essentially if we were down \$5 million, we thought we could safely remove about \$25 million from the company, half regarding people investment and half regarding variable investment.

And so, what I would say is that as we stand today, we've addressed the half that is going to impact people. If this deteriorates further, the next steps are not to take further actions where we have to restructure people out of the company, we've essentially addressed that. The next \$5 million that we have teed up we talked about earlier we know exactly where that is, we know exactly how to pull that and I mean like down to the penny, we know exactly how to do that, so that's pretty clear.

The following \$5 million, we have pretty good general buckets of how to do that and we'll monitor whether or not we have to get in there and get – and just pull that lever. We don't think we'll have to do that. So let's imagine Deane that we go below the negative 2% scenario. If you go below the negative 2% scenario, there's about \$5 million more in cost that we would go after and then from there, frankly, we'd ride the decrementals and they are – one of the wonderful things about IDEX is we have incredible incremental margins, but it is painful on the downside.

And so if we get kind of below 2%, we'll remove another \$5 million, so we'd have about \$25 million of costs out and then from there, we'd probably ride that out to a down \$5 million. If it's more than a down \$5 million, we got a different scenario and we'll have to get more aggressive, I do not see a scenario where that happens.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Great. I really appreciate you segmenting out head count versus fixed, and that roadmap gives us good color as to how you proceed going forward, so I appreciate it. Thank you.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

You bet, Deane.

Operator: Our next question comes from Andrew Buscaglia with Berenberg. Please proceed with your question.

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

Hey, guys. Just wanted to clarify something. So you kind of walked down a preliminary guide. I know it's very early on, but you were saying down 2% to up 2% at one point and then...

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Oh, yeah.

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

...to get to flat to down 2%. But then, you said early on in the Q&A that industrial is not really getting worse.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah.

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

So, can you guide – it seems like the guide implies that things – you're a little more pessimistic here. Can you just kind of bifurcate that?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So, let me just – I want to separate a little bit of what you say and make sure I understand it well. I think you've got a question there that's about the tightening up of our range and...

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

Yeah. To the low end.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. And then about the impact on the full year and then I think there's something in there you're asking about the first half. Is that correct, Andrew?

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

Yeah. I thought you made the comment in the industrial, you saw industrial, and you don't think things will get worse from here.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So if – so I think I answered when I – when Mike asked the question earlier, if you look at that guide of 0% to negative 2%, so back in the fall, we thought the range was plus 2% to negative 2%, depending upon what happened with the industrials. The industrials weakened further, so that's what – that's what's really brought us to the 0% to negative 2%. So that's the first part of it.

When Mike was asking kind of what would have to happen relative to the year, effectively, if we stay exactly where we are today and things in the industrials continue to be as weak as they were at the end of the fourth quarter, that's where I would see a negative 2% scenario. And that is – I don't believe that that is the basis of where we should be, and so that's why it's the low end of the range. If things get a little bit better in the industrials in the second half of the year, that's how you get to the 0%. So that's that range in there.

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

Yeah. Okay.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

And so, it really is what happens to the industrials for the balance of the year. My expectation is, because the comps are pretty tough in the first and second quarter, is that that's going to be a harder part of the year. So first and second quarter, the first quarter being the hardest, with very modest improvement in the second half of the year.

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

Got it. Okay. Okay. And then, in Health & Science Technologies, you had good growth the past couple years, and then this year kind of moderated. But it seems as though you're on the – from EBITDA margins and margins in general are – well, on the EBITDA margin level, they've flattened. So what – I guess, what is the long-term goal for margins here or what do you need to get those growing? Is M&A in this space something that you might be missing – the missing link to push those margins higher?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So in terms of terms of growth, we would expect over the long term, and so I'm going to say kind of over a three-, four-, five-year period, so a good part of a cycle, that HST is going to modestly outgrow the company as a

whole. We've kind of said over time probably a point or so better in growth. And I believe that will still hold. I think that will be true over a given period of time. In any one quarter, who knows? But in – over any given period of time, I think that will be the case. In terms of margins, the story at HST is no different than the story at the rest of the company. Our margin expansion comes – when we're growing organically, we have high variable margins, and so we really get nice margin expansion, especially as we drive productivity.

We have a little bit less pricing flexibility in HST than we do in FMT. But still, we get positive price, in total, in that portfolio. So I'd expect us to expand margins as we continue to grow the business.

Acquisitions in HST, we've made several. We've built the entire Sealing platform in the last number of years, and so we'll continue to do that. I don't see that as a margin enhancement. I don't see us buying things at 30% and 40% EBITDA margins. What I would expect is we'll...

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

Yes.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

...buy things that have high structural barriers, good fundamentals, and things that we can improve margins over time. So I'd expect us to buy things that are kind of in the high teens to low-20s EBITDA margins and things that we can get into the mid to high-20s.

Andrew Buscaglia

Analyst, Berenberg Capital Markets LLC

Q

Okay. Thank you.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Thanks, Andrew.

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

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Hi. Good morning, everyone.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Hey, Brett.

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Hey. Could you just provide some context around inventory in the distribution network, and specifically for FMT, and I guess really how that stacks up against what you're seeing in POS and sell-through rates in January?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So, Brett, as you guys know, we don't have a lot of stocking inventory at distributors. So our distributors generally aren't – don't have a lot of our stuff on their shelves waiting to be sold. So it's a little bit different model than some people who are selling to the classic big distributor. So we don't – we tend not to have that phenomenon of restocking/destocking in a big way. It happens in small ways, but it tends not to happen in big ways.

That being said, there are places that we track POS and it gives us some good information. What I would say in those places is that inventories seem to be at about the right levels. And so, I don't expect some significant destocking. I think sell-through and sell-in are pretty close, right now. That being said, I think, generally, distribution is pretty hesitant. I think there's an awful lot of hesitancy happening in distribution. They're watching their cash flows very, very carefully.

So the best thing that we can do in those things is drive lead times down, right? So if we can drive lead times down, those folks who do have stocking distribution, it's a better overall cash flow scenario for them, and that drives differentiation. So if you look at some of our businesses that do sell into distribution, there's an awful lot of focus on bringing down lead times as a piece of competitive advantage.

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Okay. Great. And just want to come back to restructuring. I was wondering, you gave a little color around the nature of the actions you're taking, but are these simply just shift reductions that help you navigate the near term, and then as we think about the back half or even next year and growth starts to inflect positive, some of these costs come back, or are these structural moves that you think you can just do more with less?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

It's a little bit of both, and it's a balance between some corporate costs coming out and costs coming out at the business units. What I would expect is that as business comes back, there will be some cost that comes back for volume-related. But I don't think all of it would come back kind of equivalent to revenue growth certainly in the short term, right? So one of the things that we've said very consistently is we're a business that can react very, very quickly on the upside, and so we tend to hold back a little bit so we don't find ourselves being over-capacitized or having too much overhead structure. So I'd expect it to come back a little bit, Brett. But we'd probably – if things improve, what you would expect from us are better-than-average incremental margins on the upside in the near term.

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Okay. Great. Thanks for the color.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Thanks, Brett.

Operator: Our next question comes from Joe Giordano with Cowen & Company. Please proceed with your question.

Francisco Amador

Analyst, Cowen & Co. LLC

Q

Morning, guys. This is Francisco on for Joe.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

...Francisco.

Francisco Amador

Analyst, Cowen & Co. LLC

Q

Hi. So just wanted to get clarification on one of the remarks made on the Q4 highlights of FMT. You guys mentioned the chemical market and targeted initiatives driving positive sales in the quarter, but you expect the project funnel to decrease. Is this funnel decrease specific to chemical or broad based in general? And do you have any expectations specific to the chemical market?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Yeah. So it's very specific to the niche parts of the market that we serve. I would not use us as a great barometer for the chemical market. We're probably not the best people to tell you what's going on strategically in the chemical market. We have had one business unit in particular that's had a wonderful penetration with new products and new markets, specifically into China, which has been a big win for us. But even just globally, that business unit has really turned itself and won a bunch of market share and I think that will continue. And so we feel pretty good about that piece of business in those applications in the markets that we know well. But again, I wouldn't use us as a general barometer, Francisco.

Francisco Amador

Analyst, Cowen & Co. LLC

Q

Okay. That's helpful. Thank you. And then specific to dispensing, I know sales have been challenging here and I think you guys said you expect that to be flat for the year. If we could just get a little more color on the nature of the market, do you have recovery expectations on the longer term and any more details around this?

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

A

Actually the core markets are healthy. So if you just kind of look at the core underlying markets, there's not significant deterioration or anything like that and I don't think we're losing market share. It's really the nature of these projects that come in and out, so when you think of the big purchasers that are out there, they tend to run in multiyear cycles and as we look at 2020 or if you look at kind of the back half of 2019, there was – we had a pretty good size order in 2018 that we finished out. 2019 was obviously softer in the fourth quarter, actually through the year in terms of those bigger things and we don't have an expectation that one is going to land in 2020. And so, what that would say is probably as we think of 2021, it's probably likely that we would see one of the big players come back to the market for a refresh, but you just don't know. So as we're planning right now, we're planning on 2020 to not have a big refresh of any kind.

Francisco Amador

Analyst, Cowen & Co. LLC

Okay. That's very helpful. Thank you, guys.

Q

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Thank you.

A

Operator: Our next question comes from Brett Kearney with Gabelli Funds. Please proceed with your question.

Brett Kearney

Analyst, G.Research LLC

Good morning. Thanks for taking my question.

Q

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

You bet, Brett.

A

Brett Kearney

Analyst, G.Research LLC

Your fire business continues to perform well. Can you talk about what you're seeing in that area, some of the municipal markets you serve and then how the SAM system is plugging into your overall efforts to serve fire customers?

Q

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Yeah. No problem. So, I would say that overall the municipal markets are kind of benign. They are not growing particularly quickly and there – and we're not seeing a slowdown from where we've been. So it's very similar.

A

Fire has been as – we really – if you go back to the Akron acquisition back in 2016 and then the small technology acquisition that we made here a little while ago, it's the combination of those assets that has been driving growth for us. And we would expect low-single digits to continue. The strategy that the team has put together there and is playing out in terms of being able to bring more high-value content to customers now moving more into technology, we think, is a winning move that's going to play out for a long time.

We have seen a lot of interest in SAM. We do have some initial orders. As I've said in the past, it's going to take a long time for this to see the market to get to a tipping point just because the markets move so slowly and there's already a year of backlog. And so you got to kind of work through that. But I would say that the initial signals for SAM are really encouraging.

Brett Kearney

Analyst, G.Research LLC

Thanks so much. Appreciate it.

Q

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

You bet, Brett.

A

Operator: Ladies and gentlemen, we've reached the end of the question-and-answer session. At this time, I'd like to turn the call back to Andy Silvernail for closing remarks.

Andrew K. Silvernail

Chairman & Chief Executive Officer, IDEX Corp.

Well, thank you, everybody. I appreciate your time here this morning and your interest in IDEX. Obviously, the world that we're in right now is challenging, but it's not unfamiliar; we've seen this before, and I think the key to it is, is our ability to really control our own destiny. So continuing to invest in growth, continuing to drive productivity, continuing to get strategic pricing in the marketplace and most importantly, investing in our people. That has been the differentiator for us around our culture, and we're going to continue to do that. And I'd like to thank everybody at IDEX for the incredible work that they've done over time and really turning this into a wonderful company. So look forward to talking to you all again here in the next 90 days. Take care.

Operator: This concludes today's conference. You may disconnect your lines at this time and we thank you for your participation.

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