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# IDEX Corp (IEX) CEO Andrew Silvernail on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-29-19 Earnings Summary

*Press Release* *10-Q* *Slides*

EPS of $1.52 beats by $0.06 | Revenue of $624.25M (0.22% Y/Y) misses by $-17.41M

## Earning Call Audio

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IDEX Corp (NYSE:IEX) Q3 2019 Earnings Conference Call October 30, 2019 10:30 AM ET

**Company Participants**

Michael Yates - VP & CAO

Andrew Silvernail - Chairman, CEO & President

William Grogan - CFO & SVP

**Conference Call Participants**

Michael Halloran - Robert W. Baird & Co.

Deane Dray - RBC Capital Markets

Nathan Jones - Stifel, Nicolaus & Company

Matt Summerville - D.A. Davidson & Co.

Brett Linzey - Vertical Research Partners

Andrew Buscaglia - Berenberg

Joseph Giordano - Cowen and Company

**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.

**Michael Yates**

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 3 months ending September 30, 2019. And later today, we will file our 10-Q. The press release, along with 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 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 log on to our company's homepage for the webcast replay. Before we begin, a brief reminder. This call may contain certain forward-looking statements that are subject to the safe harbor language in the 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.

**Andrew Silvernail**

Thanks, Mike. Good morning, everybody. I appreciate you joining us to discuss our 2019 third quarter operating results. In the 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, 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 decontracting 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 continuing to invest aggressively in our exceptional long-term growth prospects.

We've built IDEX to perform throughout a 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 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 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 it 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 on financial results and the segment details.

**William Grogan**

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 and 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 a 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 was 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 U.S. Treasury regulations as well as the mix of global pretax 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 '19.

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. Preseason orders are flat compared to prior year period, and we are not forecasting any near-term change to the U.S. 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 1/3 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 MPT 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 projects 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 continued 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. U.S. performance was slow due to a delay in FEMA spending, but expectations are that we'll see a rebound in the fourth quarter.

BAND-IT 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 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 will now pass it back to Andy to provide an update on our 2019 guidance.

**Andrew Silvernail**

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. The 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 million 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 to 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 costs 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.

**Question-and-Answer Session**

**Operator**

[Operator Instructions]. Our first question comes from the line of Mike Halloran with Robert W. Baird.

**Michael Halloran**

So let's start with the underlying trajectory, what you're seeing right now. Lots of puts and takes in the order numbers. SMT is flattish, which is typically a more cyclically sensitive business. The other pieces had some project timing related things. So maybe you could just talk about what you're seeing as like the core underlying demand characteristics today. What that trajectory looks like through the fourth quarter? And then maybe some puts and takes on how you're looking at growth for 2020.

**Andrew Silvernail**

Sure. So Mike, first of all, good question. That's the biggest one that's on our minds. If -- 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 -- 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 3 things and you neutralize those 3 things and you look at the underlying run rate of the business, it's basically flat to down 1%. It's 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 in -- 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 got 2 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 kind of flattish revenue growth in the fourth quarter feels about right. And then you'll face some tougher comps in the second -- 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 based on our short-cycle nature of our business. What I would say, the first pass, that looks like a tougher first half, easier second half, balanced out with somewhere in a range of, I want to say, plus 2% to negative 2%. 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**

No. That makes a 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 at 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?

**William Grogan**

No. Yes, 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, 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.

**Operator**

Our next question comes from the line of Deane Dray with RBC Capital Markets.

**Deane Dray**

Andy, I appreciate that you made the comment that you were signaling that there was slowing going on. In fact, you were among the first senior guys back at the EPG Conference in May to say a slowing was happening. So as -- so no one should be blindsided by this. But as you -- orders inflect negatively here, what -- 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 -- willingness 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?

**Andrew Silvernail**

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 it publicly at EPG. The -- as you look at this, the issue at hand is that there's just a real hesitancy based on the uncertainty in the marketplace, right? There's 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. But what that's doing is it's reverberating back and people are just hesitant to spend, they're hesitant to hire. We 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 revolve -- resolve itself anytime soon, right? So you've got the constant back and forth regarding trade tensions that are out there. The folks who seem to -- with anybody who knows what's going on, the folks who spend a lot of time on this are very doubtful that any meaningful 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, 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**

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. 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 Silvernail**

Yes. 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 3 continue to struggle and then you've seen the industrial start to come down, right? FMT, which is 2/3 of our industrial exposure or 1/2 our industrial exposure, you can see, although it's still good relative to what 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 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, you'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 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 and health of science, those are going to hold in.

**Deane Dray**

Yes. That's exactly what we'd expect. And look, you cannot control the slowing on the end markets, but you're obviously doing a great job on margins and cash flow, so congrats on that.

**Andrew Silvernail**

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 it 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.

**Operator**

Our next question comes from the line of Nathan Jones with Stifel.

**Nathan Jones**

Come on, Andy, control the end markets. 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 were anticipating. Maybe you can talk about whether you need to reduce your inventory levels here in the face of this lower 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 Silvernail**

Yes. 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 Jones**

So you're not in any kind of heavy downturn here. You're talking about flat 4Q, kind of plus 2% to minus to 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 Silvernail**

Yes, 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 this is, number one, you want to invest in the things that drive long-term, sustainable competitive advantage and 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 bets 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. 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 tough comp in Q1, Q2 and then an easier comp in the back half, weighing out to that kind of plus 2% to minus 2%.

**Operator**

Our next question comes from the line of Matt Summerville from D.A. Davidson.

**Matt Summerville**

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 Silvernail**

Yes, Matt. Bill, you want to tackle it?

**William Grogan**

Yes, sure. No, I think it was -- Europe is going to maintain its lower level that we've seen over the last couple of quarters. It was really more declines in North America that we started to see that broader orders -- 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 in China, our teams really delivered on their targeted growth initiatives and grew in the upper single digits in those areas.

**Andrew Silvernail**

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

**William Grogan**

Exactly.

**Matt Summerville**

Got it. And then just back maybe to FMT margins, up $270 million sequentially. Up, I think -- or $270 million year-over-year, up $170 million 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 Grogan**

Yes. 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 projects that they had. And then the 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.

**Operator**

Our next question comes from the line of Brett Linzey with Vertical Research Partners.

**Brett Linzey**

Just wanted to come back to price cost. It sounds like you got a very good price traction in the quarter. You do start to lap a tough like-unlike 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?

**Andrew Silvernail**

Brett, we'll get positive price in 2020, I feel very confident in 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 to 40 bp price cost leverage that we've gotten in the past.

Bill, anything else you'd add to that?

**William Grogan**

Yes. I think the spread as we come into the back half was -- 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 we'll still be significantly positive on the price cost differential.

**Brett Linzey**

Okay. Great. And then just shifting to the funding delays in rescue. It 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?

**Andrew Silvernail**

Yes. 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 relieve. Why? Because we're very close to our customers, and we know when money is going to be relieved just generally. So we feel pretty good about that. 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's not going to happen or hasn't happened already.

**Operator**

Our next question comes from the line of Andrew Buscaglia with Berenberg Capital Markets.

**Andrew Buscaglia**

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 what -- why do you say that? Or what are you seeing specifically?

**Andrew Silvernail**

Yes. So it's not a big chunk in total.

**William Grogan**

About 3%.

**Andrew Silvernail**

It's about 3% in total for the business. 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're 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 it's -- a lot of that has been a share game on top of what's happening to the market. So in other words, Andrew, we're getting direct signals from people on higher demand to get our supply chains ready. But to be clear, I would not use us as a bellwether for the semiconductor market. We are not the right people to talk to about that.

**Andrew Buscaglia**

Got it. Okay. And then I know people are kind of taking up this question a bit, but it's -- you hurt your sales only about 2% -- or you'll do about 2% this year. And you really -- you drove a really impressive incremental margin off of that. That's on the heels of strong incrementals in the prior year. So the question is how long can you keep this up at -- if you're only -- it sounds like, 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.

**Andrew Silvernail**

Yes. I think -- so there are a couple of things that really matter there. The first one is the overall top line, when you -- when we are -- I want to call it 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. Second, that price cost -- what you get between price and cost, 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 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 work to really hold the line is what we 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**

Okay. And I guess, the flip side is you're -- you sound like it's unlikely margins will degrade much, if anything.

**Andrew Silvernail**

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 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. We're -- 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. And 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 trade-offs. 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 generally.

**Operator**

Our next question comes from the line of Joe Giordano with Cowen.

**Joseph Giordano**

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?

**Andrew Silvernail**

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.

**Joseph Giordano**

Okay. And then is your fourth quarter in HST -- I know some of it seems timing related with the order decline there, but is that like a direct impact into the revenue number that you anticipate for Q4 there?

**Andrew Silvernail**

I don't think it's a big impact. It's just that timing of that order, those things are blankets that are going to be in the future. So I'm not -- I don't think that's a real impact to the fourth quarter.

**William Grogan**

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

**Joseph Giordano**

Okay. And then if I could just clarify something, Andy, I think you -- 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 decline. Did I just hear that?

**Andrew Silvernail**

Yes. 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 we did nothing, right? So that's 50% of the contribution margins of the company.

**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 Silvernail**

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 for -- 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.

**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.