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PRESENTATION

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Good morning and good afternoon, everyone. This is Markus Mittermaier and heads up the U.S. multi-industry team here at UBS. And I'm delighted to welcome Fortive at this year's UBS TMT Conference.

The format today will be a fireside chat for 40 minutes. If you'd like to ask a question, please use the little text box that you see on your screen or simply e-mail me at markus.mittermaier@ubs.com.

With us today are Jim Lico, President and CEO; as well as Chuck McLaughlin, SVP and CFO. Gentlemen, thanks so much for taking the time today.

And without further ado, let me hand it over to Jim now for some opening comments.

James A. Lico - *Fortive Corporation - President, CEO & Director*

Thanks, Markus, and good afternoon, everyone. It's wonderful to -- happy Monday. It's great to start the week with an opportunity to talk a little bit more about Fortive. We obviously have had a very busy year despite many of the challenges of COVID. Chuck and I are obviously excited to talk about kind of where we're at today as we sit here in December and look forward to finishing the year here and looking into 2021.

For those who know the story, this might be a repeat. But for those who are new to the story, we certainly are incredibly excited about the work we've done since we spun out of Danaher in 2016 to really transform the company. And I think where we stand today after the Vontier separation, we're very proud of the work we did, and we're excited about the opportunity for Vontier to move on as a separate, independent company. And we're incredibly excited to talk about what New Fortive looks like and the opportunities available to us as we push into 2021 and beyond.

So a lot accomplished this year. We won't spend as much time on that as we will about the future. But Markus, thanks for the opportunity today to talk, and we'll look forward to questions from you and from others.

QUESTIONS AND ANSWERS

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Great. Thanks so much. And it was a great segue, reflecting on a busy year. And as we look forward, we have the TMT conference today, and hopefully, we'll have the chance again to talk at our Industrials Conference in June.

So if I can ask, for the next 6 months between now and then, what are your top priorities as you think about starting the new year now post the separation? And then maybe more long term, hopefully, post COVID, what are the 2 or 3 things that you are focusing on now in your thinking?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Yes. This is Jim. I think, number one, obviously, 2020 has been a year in which you really have to be -- I think pushes everybody's manual dexterity and ability to be ambidextrous in new and different ways. Obviously, a big focus of the year was the work we did from a transformation perspective, not only on the portfolio, but on the digital transformation to get roughly 2/3 of our worker -- workforce now working productively from home. We're incredibly proud of the work we've done to do that, Markus.

So I think that was a big focus, obviously, in the summer. Getting Vontier separated as well as a number of the acquisitions that we've done over the last few years have been a high priority. Those will continue to be -- certainly, the safety of our employees will continue to be top of mind as we look into the next few months. Obviously, the news recently here on vaccines and some of those things are incredibly important. But we also know that with increased caseload comes increased diligence on the part of our leadership team to make sure that our team members are safe.

While we continue to build the business strategically, I would say if you were to look -- what are our 2 or 3 real places of focus?

Number one, I think what we've tried to do over the last year, several years is to continue to accelerate the innovation capability of Fortive broadly across all of our operating businesses. And I think we've been -- we've made great progress in that, but believe that still remains a great opportunity. What you'll see now, and I'm sure we'll talk more about it, in our new segments of Fortive are 3 operating segments that have tremendous opportunity to play deeper in customer workflows, really not only with the hardware advantages that we really have had from a legacy perspective over decades of business and dealing with customers in those industries, but now the opportunity to bring more software, bring more data analytics into those workflows to build more sustainable customer relationships and, quite frankly, build more sustainable business models.

So we're very early days in that. And we'll talk a little bit more about those priorities, but I think the work we're doing to continue to build out our capability on the software side, to continue to build the technology infrastructure in which to support that, to really focus the Fortive Business System on ways to really accelerate all of our strategic work, I think, really remain -- and then certainly to bring more data analytics into our solutions as machine learning and data become such an important part of our offering in the decade to come. Doing the foundational work in that is -- remains a very important priority for this year, and certainly in that case, will certainly be a priority in the years to come.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Great. Excellent. yes, I'll have a couple of follow-ups in a second here on that.

But before we get there, just from an organizational setup, if I look at the structure post separation now. I was wondering, internally, is that how you've run things now for a while? Or is there some rearrangements in the structure and org chart happening at the moment? I mean, from the outside, it seems the real big move was Fluke Biomedical. But is there any other sort of big internal adjustments that you're working through? Or is it pretty much ready to go in the new structure?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Yes. The short answer is it's very much how we've been running the businesses over the last, really more than 1 year. So I think in that sense, very little change. You mentioned the Fluke Health move from what was used to be field solutions platform now into the segment for health care.

So we think the segment gives -- obviously gives tremendous clarity around our financials and the growth opportunities that exist in those segments. But from an operational perspective, very much same as usual for our operating leaders and for how Chuck and I really interact with those businesses.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Okay. Great. And then coming back to the priorities you just mentioned. I mean, if I look at the portfolio in very broad term now, you are roughly 13% software, just under 40% recurring. Where do you see these 2 numbers go here over the next few years? What's the aspiration?

James A. Lico - *Fortive Corporation - President, CEO & Director*

I think we start with -- it's -- we're incredibly proud of where those numbers are. And I think those numbers are reflective of the strategic work that we've done to really engage more deeply with customers. So obviously, the software percentage and the recurring revenue, and I'll get back to maybe what those might look like. Those numbers were -- the software numbers were low single digits when we spun out of Danaher, the recurring revenue was about half, maybe a little less than half. So certainly, a dramatic effect in less than -- in about 4.5 years relative to those numbers.

But it really is about our strategy. And our strategy is really to continue to look at what customers are trying to do. And increasingly, they want to do more with the engagement we have with them. They see the strength of our instrumentation, our sensors. They want to do more with that. They want to get the data from those opportunities. And then they want to be able to do something with that data around analytics.

So I would say, if you were to say if past, I would not predict, we don't -- we do set some internal goals around those numbers in terms of both the organic and inorganic work that we would do to make sure that we continue to increase those percentages. But it really has to do with really making sure that our strategies are resonating with customers. And obviously, there's an organic part -- inorganic part of that, which is hard to predict.

But I would say if you just saw the growth rates of our software businesses and said, "They will certainly become a larger part of Fortive in the future just because of their organic growth rates being higher." You would suspect the majority of our capital allocation will be -- will really be to move those businesses forward and to add new businesses into our portfolio that look similar to a Censis or an Accruent or eMaint.

And so I would say those percentages will be dramatically different in the decade to come, but hard to predict in the next 2 or 3 years what that might look like. But it is safe to say that those percentages will continue to increase. And obviously, it really helps us build a longer-term, more durable relationship with customers. And the outgrowth of that is a higher-growth, more durable business model.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Okay. Great. I'd get to M&A in a second. I already get some questions here from clients on the topic as well. But maybe staying sort of with the broad sort of overview for now.

As we think about, again, the new portfolio and sort of through-cycle growth rates, as is, without sort of incremental M&A, do you see this as sort of like a GDP-plus-type growing business? Is it mid-single digits? Or how should we really think about this through the cycles?

And then on incrementals, I know that you kind of in the past guided us to 30%, 35%, in that range. How should we think about that going forward? Is that heading towards the 40s? What's kind of the -- how do we think about those 2 elements here going forward?

Charles E. McLaughlin - *Fortive Corporation - Senior VP & CFO*

Markus, this is Chuck. I'll take that one. Going forward, we think through the cycles, mid-single-digit growth is the way to think of the business. Now coming out of -- when we get into a recovery period post COVID, you'll see it be a little higher. But if you take a look at the next 3 or 4 years and stretch that out, mid-single digits is where we believe that we've transformed the portfolio to. And so we feel great about that progress.

In terms of the margins that you talked about, 35% is the construct for 2021, and we think that's the right place to be. Keeping in mind it's a little bit specific to 2021 as we got some temporary costs that we managed in 2020 that will be coming back in. And so that's what -- and also keep in mind, we don't actually know. We have a range of scenarios. We're not calling the top line yet, that's the biggest unknown right now. But 35% makes sense that going forward, let's get to the other side of COVID, and it depends on, is there a rebound? How much the top line is growing? But through the cycles, I'd probably be north of 35%. But let's get through this pandemic first, and then we'll be a little bit more declarative, I think, in -- as we move through next year.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Understood. Understood. Okay. And then maybe if I look at sort of the gross margins across the board, sort of in the high 50s in the various segments. If I look at the delta between sort of gross margin and operating margin, I guess, R&D intensity varies to some extent across these businesses. But structurally, do you see that delta between gross and operating sort of stay at current levels? Or is there some room maybe ex TSA? How should we think about those, that delta there?

Charles E. McLaughlin - *Fortive Corporation - Senior VP & CFO*

Well, first, let me dive into the R&D one. I think with the separation of the companies, I think r&D, we've been funding at each operating company along the way. But it would be over 6.5% moving towards 7% over time as we move forward. A couple of things to keep in mind there is where we -- at each operating company, there's a different level of R&D. In some of the places where we have really high gross margins, particularly in our software businesses, they probably have more R&D. And they're compounding at a faster rate than their overall business. So that will quite naturally keep the pressure moving up there on R&D. That's also, we think, one of the big underpinnings to the gross margins. We'll see those continue to expand as we go forward.

When you look at the operating profit by segment, it's -- all of them are exceptional, I believe, and we'll be, as you look out a couple of years, north of 25%, pushing 30%, depending on which segment. The rate at which they bounce back really depends on how the recovery and when it starts coming out of the pandemic.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Got it. Okay. Okay. That helps. And then maybe one around your end markets and the underlying drivers for that. I mean, if I look at IOS and particularly at Fluke, a lot of your larger businesses are certainly linked to some extent, at least, to industrial production. But some pieces, particularly in Tektronix, are also tied to development cycles, standard evolution and real technological evolution over time. Is there any upcoming sort of development cycles or R&D windows that we should have in our minds, maybe for Tek, that might lead to above or below IP type growth, right, be it on the oscilloscope side or anywhere else there within Tek?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Yes. I think -- well, first, I think you characterize what we've done at Fluke pretty well, maybe just to hit that really quickly. Obviously, with Fluke Health moving out, Fluke in itself, and you remember from the groupings we showed in the last couple of quarters. The Fluke core industrial business may be a little bit more tied to that than our eMaint software and what we're trying to do at Fluke Reliability.

So I think we'll continue to evolve Fluke less towards industrial production. It will always have that aspect to it. And Fluke typically returns faster to growth, if you will, through the cycle than maybe, say, Tektronix if we're to use sort of historical economic cycles.

You mentioned Tektronix. I think what we've tried to do, Markus, over the last decade or so with Tektronix is to make it less susceptible to some of these big technology swings, less tied to things like, as you said, the semiconductor capital index and things like that. So whether that's the addition that we've made to services to really, I think, mute some of the down parts of the cycle; or it's the work we've been doing around customer and end markets to really go after opportunities like the data center market, we've seen some nice work with some of the work we're doing.

A lot of -- one of the challenges with IoT sensors and IoT connections can often be the power issues and the need for low-power sensors and things like that, that fits very well with our oscilloscope range as well as our Keithley range.

So there are a number of secular drivers that are good here. IoT is one of them. Electric vehicles is one. We've seen nice growth in our auto business as well. No one segment dominates Tektronix any longer.

So I think our ability to sort of see things come back, fundamentally, what we do see is we do see Tek -- when the economy gets better, we do see a little bit of a better bump in a short period of time, simply because people have deferred some of those purchases of a oscilloscopes. So we do see things come back a little bit quicker. Hard to call right now when that might be, but we do -- we will inevitably see that, we believe.

And I think also the work we've been doing around innovation to continue to take advantage of some of the technology trends I just mentioned is really very much part of that. Our launch here of 6- and 8 channel version of our 6 series oscilloscopes is an example. Great example of really taking advantage of some of the challenges and product development engineers have in some of these IoT device developments that we think is a good opportunity for us.

So we'll continue to build on that. And I think fundamentally, Tek, the team there, has done a wonderful job. We're also inevitably trying to figure out, "Hey, we create a lot of data in the oscilloscopes. That's always been the key part of -- the output of an oscilloscope has always been the great value that we create. How do we monetize that?" And I think we're very early days. But I would say, over the next several years, the Tektronix team has got a number of ideas that, that can be an opportunity to continue to build a growthier Tektronix as well.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

That's very helpful. And then maybe on to M&A. If I look at your total addressable market across the 3 segments, kind of pushing north of $30 billion here. Should we think about M&A sort of within these segments? Are you happy with these 3 segments? And should we read anything into AHS being sort of relatively smaller compared to the other 2 in terms of your priorities going forward? Or does that relative size between the 3 not really matter to you in your thinking?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Well, yes, I think it does matter. And I -- let me start with the $30 billion. We're incredibly -- we've had, I think at our high point, maybe $35 billion of served market in our history over the last 4.5 years. But the quality of the served market today, in terms of the quality of the businesses and the opportunity, has never been better. So I think, first of all, if I step back and just look at the $30 billion, the quality of it, in the markets and the growth, and just really, really exciting.

And as you mentioned, a little bit different in health. Maybe I think that more constitutes the fact that we now have a newer health care segment than really anything more than that. So I think the opportunities there still remain very good. If you look at what we've done over the last 4.5 years, we've deployed about an equal amount of dollar capital between IOS and Advanced Health Care. But the number of deals has been more in IOS. We -- I never want to say the past is the future. But I do think that we believe that there are unique opportunities across the segment. And obviously, we've designated some workflows. Precision tech is the place where we've not spent as much money in the last 4.5 years, but we remain optimistic that there are opportunities there as well.

So I think we have opportunities within the segments. Certainly as we continue to build on the things we've done inorganically, it adds to even more opportunities. It's probably why we see a bigger IOS opportunity because the number of deals that we've done in IOS presents us with more served market. But I think the work we've been doing strategically, particularly over the last 12 months as we've been preparing for this new segmentation and preparing for how we'll think about New Fortive, we couldn't be in a better position, both strategically and from a capital perspective in which to, I think, bring some great companies into Fortive in the future.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Okay. Great. And obviously, in that context, the elephant in the room is multiples, right? I mean, with multiples where they are, discount rates where they are. Software wasn't cheap at any point, but certainly, it doesn't look like it's getting any cheaper. How does that inform you what you focus on? And has your hurdle rate or your ROIC framework on a pro forma basis changed here in any way?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Well, I think, first, you're right, we would always like multiples to be lower for high-quality assets that we want to bring into the family. It's really about value creation. As you know, our model is, first, do we like the market? Do we like the company? Can we create value? We have to have a yes to all 3 of those.

And so I think, first, before we even talk about what the ROIC or the return on capital can be, it really starts with the market -- the quality of the market, the quality of the company and our value creation. FBS today even more appropriate for the kinds of businesses that are coming into Fortive.

So I feel very good. We would love for valuations to be different, always lower. I've been doing this for 25 years, and I never remember a time when I didn't wish that the valuation could be a better opportunity. But as I said, the quality of the businesses have gone up considerably as well, and that's inherent a little bit in if we're going to go for higher growth, more SaaS, higher recurring revenue, higher profitability, great gross margin profile, fundamentally, those are probably going to have higher valuations. So it's really about how we create value.

Charles E. McLaughlin - *Fortive Corporation - Senior VP & CFO*

And Markus, for -- on the ROICs, we haven't moved how we evaluate things. We're always looking at how long it takes us, time to get to 10% ROIC here. And I think that over the last 5 years, we've averaged, of everything we've done, between 4 and 5 years is what we're tracking to, we, of course always like to do a little bit better, but it depends on if we do a bolt-on, we'd like to get to that 10% in 3 years. And if we do more of a platform, bigger deployment, it will go to 10 years.

And so that's our construct, and we don't see a reason to come off of that. We do see things sometimes that look, in the moment, a little bit expensive. But usually, when we deploy something, that's because we think they're worth that and there's value that will be created.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Okay. That's helpful. And then maybe on the sensing business. I mean, if I look at that part outside-in, it's certainly more fragmented and it sort of goes back to the old Danaher portfolio. And you mentioned earlier that you've kind of done less on the M&A side here on that front. Is there an opportunity for consolidation? Or is there untapped potential in that business? How should we think about that fragmentedness of that market?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Yes. I think as you pointed out, these have been businesses that have been part of the portfolio for a long time, haven't really spent, hardly any, real meaningful M&A capital in those segments in that -- in those sets of businesses for quite some time.

We've done a nice job, I think in particular the last few years, of repositioning the businesses organically. Whether it be in our -- towards higher-growth opportunities in food and beverage and sanitary markets like at our Anderson-Negele business or the environmental monitoring that we're now doing as a bigger part of our business, et cetera. Fundamentally better, growthier opportunities. Still in the very early days.

We're really moving up from just being a sensor provider, in many cases, to being a broader player. As an example, we now do a digital process recorder in our Anderson-Negele business that allows for us to do some different things in the workflow.

I would see that continuing. We've just done all of our strategic plans in the last few months with those businesses, and I think they've done the best job they've ever done at capturing some thinking around that, but very early days. And if there's an opportunity to do something from an M&A perspective that accelerates that strategy, we'd certainly be open to doing that.

I think there's real opportunity. You first have to do the high-quality strategic work, which I think we've done. I think historically, we've had much more of an organic focus in those businesses. But I think the expectation is then becoming a bigger, more important part of Precision Technologies. We've raised the bar on the expectations around what they could do relative organically and inorganically, and I think the team's done a nice job of rising to the occasion.

But you never know when things like that might transpire, but I think there is opportunity there for sure.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Okay. Great. Maybe last few on capital allocation here. But in the general area of cash, we are waiting for the Vontier monetization here over the course of next year. I think you said first half or well before the end of the first half. Is that a bottleneck for anything you might want to do on the M&A side?

And then maybe as a segue, sort of leverage limitations, how should we think about equity maybe as a currency also here for potential acquisitions?

Charles E. McLaughlin - *Fortive Corporation - Senior VP & CFO*

Markus, this is Chuck. The Vontier retain stake really isn't a gating factor at all. We've -- we were actually in a pretty good leverage position before that. And also, since there's this timing to that, that will happen in -- some time in 2021, most likely. It can't go beyond that. So it's definitely not a gating factor for us moving forward.

From a leverage standpoint, what we're saying is we'll use our free cash flow towards M&A. And given that we're very -- we want to have investment-grade rating, that's very important to us. What you'll see is us stretch from time to time. And we'll go up to, say, 3.5x, but only to the point where we see a path back down into -- around that 2, if you're talking about net leverage, or a little less, that we get back.

Much like you saw us do probably over the last year, where we came into this year thinking that we're going to be a little bit light now. That was before the COVID impact, but because of the year before was really heavy. So I think that's sort of ebb and flow, but keeping our balance sheet strong is really what you can expect us to do.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Great. And equity as a potential currency going forward, is that on the -- an option at all? Or...

Charles E. McLaughlin - *Fortive Corporation - Senior VP & CFO*

Well, I think that you've seen that from a capital deployment point of view, everything has been on the table. And for the right situation? Yes, it would be. Shareholder value is the most important thing to us. And -- but we understand that, that's also one of the currencies that we have.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Okay. Great. And Jim, maybe if I come back to something you said around various scenarios you're kind of planning for in 2021. And I mean, obviously, there's a lot of balls in the air at the moment. But what are you looking at kind of to inform that decision? And maybe if you look near term at channel inventories, where do we stand there? What are your channel partners telling you? Are they at equilibrium? Should there be a restock at some point? How do you think about the kind of near-term trajectory of the different patterns that you kind of set up the business for here over the next quarter or 2?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Yes. I think you're exactly right. I think, first and foremost, we've created some scenarios and subsequent data that we'd be tracking along those scenarios to sort of have a sense. Finishing the year is important to that, Markus. I think we get a good sense of how customers are thinking about at least the first part of 2021 by how they finished 2020.

So we'll be informed over the next month or so as we take stock of where we're at, at the end of the year. I think that's an important component. The trends that we see, whether that be things like our point of sale, we got good point-of-sale data at Fluke and at Tektronix as well as with some of our channel partners and at ASP on the health care side. So we'll be looking at our -- we'll be looking at those point-of-sale trends.

I did operating reviews with a number of our European businesses last week to get a sense of what they were seeing, as another sort of formal process for us as just doing -- getting with our teams to understand. I talked with our largest channel partner in the world, the CEO of that firm, last week as well to get a sense of how they're thinking about it.

So a lot of data points. I think it all comes down to watching our point-of-sale data as well as things like industrial production and PMIs. We'll track those to see what those are going. We want to see elective procedures. That's obviously a driver in the health care business. Particularly at ASP, we're going to continue to track those things.

And just by and large, where the -- what's going on with the virus and what people are doing relative to working from home, how are we transacting business? As I've said to a number of folks, that our sales cycles have moved out as -- we've improved them significantly since the second quarter, but they're still longer. So the time it takes from a lead to the time we engage with a customer to the time we get a purchase order, that's still taking longer than pre-COVID days.

I was talking to one of our European businesses last week who said, "Hey, in the summertime, late summer, early fall, we were back to visiting customers on-site. 30-plus percent of the time. We're back to only doing that about 10% of the time because of the increase in cases." So hence, our desire to want to understand what's going on with cases around the world to understand what the pace of transacting business is.

I think we still see good durability in the business models. And so I think at the end of the day, we still kind of have a basic premise. Obviously, we have an easier comp in the second quarter, but the first half, I think, remains noisy as we see all those things transpire. We'd like to think that the second half starts to get more certainty as you start to get caseloads. I was reading something last night that seems pretty relevant around how many folks will get the vaccine and what that looks like in the U.S. Obviously still a big factor around the world. So those are certainly things we're going to track here.

I think what we know to be true is we'll continue to manage the business in a way that helps us understand that we create opportunities for us. Chuck mentioned how we think about the incrementals here. And that has, in part, wanting to continue to allocate resources around our highest-growth opportunities while still making sure that we're prepared from a earnings and free cash flow. And I think the durability of the business model means we're going to continue to do exceptional in terms of free cash flow, and that will certainly present more opportunities for us.

So stepping back to your answer, I think we -- those scenarios are really focused on really the number of things I described. And that probably rolls up to a little noisier first half and a little bit more certainty in the second half, hopefully. But still a lot of work to be done between now and then to really see if that actually plays out.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Okay. And I appreciate it's obviously hard at the moment to make any sort of prediction. But maybe coming back then to a more strategic point and longer term, what we talked on software earlier. There's a lot of companies out there that talk about IoT, industrial software, industrial tech, et cetera. But then you look deeper and you actually hunt for tangible kind of software revenue dollars or tangible sort of evidence that these business models lead to top line, bottom line, et cetera. The answer often is they are just being developed, right? And we don't really know yet.

Now with you being a sort of 13%-ish organic at the moment on the software side, do you think sort of being embedded in the -- in these -- all these workflows at your customers, is -- does that make it easier with your legacy hardware to cross-sell to up-sell versus maybe the average company out there? Or how should we think about that incremental step to actually tell a customer that Software ABC might be something that they need which they probably never thought about?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Yes. It is -- it definitely -- well, first of all, I think the tangible results is an important point. Chuck mentioned, if you look at our gross margins now nearing 60%, if you look at our recurring revenue at just nearing 40%, you could look at our net retention and some of the things we talk about relative to our software businesses, I think those are the real evidence points of real transformation.

As you said, we're going to follow our customers here in where they want to go. And what they're telling us is because of the domain expertise that we have in these workflows, because of the presence and the decades of relationships that we have at a Fluke or a Tek or an ASP, as an example, those strong relationships are ultimately going to help us, give us degrees of freedom and opportunity in which to extend our business models with them, extend our business relationship. And we're really getting, in many cases, pulled into those opportunities because of the long-term relationships.

And I wouldn't discount the domain expertise. Because to really build the accurate data models, as an example, around these businesses, having domain expertise is a real asset. So as an example, we bought PRUFTECHNIK 1.5 years ago because of their deep understanding of vibration. That deep understanding allows for us to build data analytics models around condition monitoring that ultimately gives us an advantage.

So I think, first and foremost, you talk about the tangible things. And I think when you look at Fortive, you see the real tangible results of our business model changing, our financial results changing and those kinds of things.

And then within the businesses, there's very unique stories. As I mentioned, at Fluke and what we do with eMaint, we're very much in condition monitoring. We're very much leveraging the positions that we have at Fluke to continue to extend our business models.

And the range of businesses at [according] and Accruent, where we don't really have -- we come from some domain expertise in facilities management, but quite frankly, we're moving farther and faster around maybe being a little bit more agnostic and being hardware-agnostic and really being able to leverage our domain expertise into the deep software relationships that we already have.

And then in health care, a slightly mixed opportunity. Certainly an opportunity to leverage customer relationships, but at the same time, we're going to -- we're also going to have some partnerships, if you will, like at a Censis with a Cantel Medical that we announced today as a partnership opportunity to extend Censis while at the same time building our ASP business.

So it really does depend on how we go to market within the workflow. But I think what is constant and foundational is our domain expertise for sure. The ability to really extend ourselves with customers and globalize the business, take advantages of our global footprint. And then finally, just really continuing to think about how we expand and invest in the businesses to move our software solutions to more data analytics, machine learning, to fundamentally help customers get even more value out of the software dollar.

So the upselling and cross-selling that comes from that is really very, very early days in these businesses, but really does give us a great opportunity for long-term value creation beyond just what we're doing with software today.

So hopefully, that gives you both a strategic and a financial view. I think the tangible results will continue to accelerate. The business model transformation will continue to accelerate. That obviously means higher free cash flow, better recurring revenue and a more durable business model for Fortive.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Yes. Got it. And you mentioned Censis. Maybe if we can make that a case in point here. Because one of the question that obviously comes up is like what's the incremental margin on some of the SaaS revenue that you generate, right?

And if I look at Censis, is it fair to assume that, that largely gets pushed through your -- or could get pushed going forward through your kind of ASP sales force? And therefore, SaaS incrementals should be quite high? I mean, I know that in practice, they can range widely. But is that fair to assume, that we should have very, very accretive sort of incrementals if you can push that to existing sales forces?

And to what extent is that true for some of these software companies that you've built or integrated?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Well, I think certainly, you really, I think, very much characterized how -- our starting point, which is building off our hardware advantage and our domain expertise. And it does vary in various sectors.

So in a -- as I mentioned, and just to deal with your question directly. Certainly in the case of a Censis, we're going to continue to invest in that business as a stand-alone business because of the opportunities. There's certainly going to be opportunities to leverage relationships and partnerships that we have within the ASP business and the global footprint that exists. So it will sort of depend, particularly on the part of the world where we're trying to accelerate the business.

I think the one standing fact you can say is that the health care, and just take health care in general, we continue to believe that, that our relationships in terms of how we deal with hospitals, maybe in the United States, the ability to leverage those relationships, is certainly a core foundational part of creating value.

The incrementals will -- are always going to be high on software, but we're also going to continue to make sure that we're investing in the future, globalizing the businesses to some extent. As an example, you saw Accruent very well in the third quarter in Europe because we're trying to really grow that business and extend it in Europe.

So we're always going to be in a growth mode in these businesses, too. So there will be -- there will always be that sort of managing of how much money we put to the bottom line. But certainly as you point out, in software, the starting point of the contribution margin that comes from software, obviously, always going to be high. And it will always be dependent on the growth opportunities and how we accelerate growth. And that will differ by workflow. But clearly, your thesis that we have a foundational opportunity with hardware to build off of is certainly true.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Great. And I know we are coming towards the end here, but maybe 2 quick ones. Well, I don't know they're that quick, but let's see.

When you buy some of these maybe smaller company and midsized companies, how do you actually make sure that the talent stays, right? And how do you kind of manage the integration here? What's the track record been on some of these integrations?

James A. Lico - *Fortive Corporation - President, CEO & Director*

Yes. Talent's critical in these businesses, for sure. I think we're very fortunate to have been incredibly successful at retention. It doesn't mean that every single person stays. But I think if you looked across, as an example, the software businesses, the folks today in terms of leading the businesses are all have been within the business. So we have a real opportunity. We're building real scale in terms of talent capability across our software businesses. So that's obviously a really important aspect. I think we've become a place for talents, our ability to bring in folks from the outside to supplement our capability as well has been pretty good.

So I think, on balance, our talent retention has been good. It's important. And it continues -- we don't take that for granted. But I think what it's starting point is, is our independent operating model. When -- we don't get -- our businesses don't get sort of deluged into a big, amorphous organization. Our stand-alone operating company model really means we continue to stay entrepreneurial. We stay focused to the customers that are there. And I think that ultimately is our business model that is a key part of our retention strategy as well.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Great. Okay. And then maybe anything that I should have asked that I haven't asked given the 40 minutes we've had? And if not, then I'll leave the floor to you for some closing remarks, if that's okay.

James A. Lico - *Fortive Corporation - President, CEO & Director*

Yes. I think, first of all, I'm remembering that I didn't answer your question on channel inventories as closely as I could have. Just -- and we haven't seen much of an impact on channel inventories. I wouldn't expect that probably to be too much of a change until we get more certainty in terms of what the outlook looks like, probably later in 2021, in terms of building up inventories, just as an answer to that.

I think more specifically, I think you covered the gamut. I think as we continue to really get out, we're really trying to demonstrate to folks the importance of our segments and the workflows associated with that. And you had so many questions around that. I think that's what we continue to try to emphasize, as Chuck and I have gotten out here since we announced the Vontier separation. So we'll continue to emphasize that.

And I think the meaningful, or to use your words, the tangible results in terms of the changes and transformation of our portfolio, whether that be in recurring revenue, whether that be in gross margins or just the free cash flow that we're generating on the revenue base today, much higher than what we did, say, 4 years ago. I think all of those are in the very early innings of, and I think we continue to want to make sure that we tell that story.

A lot has changed here in the last 12 months, not only around COVID, but in our business. So I think what we're focused on is what you were focused on, which is really trying to -- really try to get the questions out there and try to give people maybe more of an illustration of what that looks like for 2021.

So I just want to thank. Markus, thanks for the opportunity today to talk. And just want to make sure, as we get here into the tail end of the year and into the holiday season, to wish everyone is safe and healthy holiday season. We appreciate everyone's support. We look forward to seeing -- hopefully maybe seeing everybody in person here some time in 2021.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Excellent. Thanks so much. And thank you.

James A. Lico - *Fortive Corporation - President, CEO & Director*

Thanks, Markus. Talk to you soon.

Markus M. H. Mittermaier - *UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research*

Thank you. Bye.
