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AME - Q2 2016 Ametek Inc Earnings Call

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OVERVIEW:

AME reported 2Q16 sales of $977.7m and diluted EPS of $0.59. Expects 2016 revenue to be down low-single digits on a percentage basis from 2015 and diluted EPS to be $2.28-2.32. 3Q16 sales are expected to be down mid-single digits vs. 3Q15 and diluted EPS is guided to be $0.54-0.55.

CORPORATE PARTICIPANTS

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Bill Burke *AMETEK, Inc. - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Nigel Coe *Morgan Stanley - Analyst*

Robert McCarthy *Stifel Nicolaus - Analyst*

Scott Graham *BMO Capital Markets - Analyst*

Allison Poliniak *Wells Fargo Securities, LLC - Analyst*

Christopher Glynn *Oppenheimer & Company - Analyst*

Matt McConnell *RBC Capital Markets - Analyst*

Richard Eastman *Robert W. Baird & Company, Inc. - Analyst*

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Akshay Bhatia *Bank of America - Analyst*

PRESENTATION

Operator

(Operator Instructions)

I would like to welcome everyone to the AMETEK second-quarter earnings conference call.

(Operator Instructions)

Mr. Kevin Coleman, you may begin your conference.

Kevin Coleman - *AMETEK, Inc. - VP of IR*

Great. Good morning. Thank you everyone for joining us for our second-quarter earnings conference call. With me this morning are Dave Zapico, Chief Executive Officer and Bill Burke, Executive Vice President and Chief Financial Officer. AMETEK's second-quarter results were released earlier this morning. These results are available electronically on market systems and on our website at the Investor's section of AMETEK.com.

This call is also webcasted and can be accessed on our website and at streetevents.com. The call will be archived on both of these sites. Before we get started, I will remind you that any statements made by AMETEK during the call that are not historical in nature are to be considered forward-looking statements. As such, these statements are subject to change, based on various risk factors and uncertainties that may cause actual results to differ significantly from expectations.

A detailed discussion of the risks and uncertainties that may affect our future results is contained in AMETEK's filings with the Securities and Exchange Commission. AMETEK disclaims any intention or obligation to update or revise any forward-looking statements. I'll also refer you to the Investor section of AMETEK.com for a reconciliation of any non-GAAP financial measures used during this call. We will begin with some prepared remarks by Dave and Bill and then we will open it up for questions. I'll now turn the meeting over to Dave.

Dave Zapico - *AMETEK, Inc. - CEO*

Thank you, Kevin. Good morning. AMETEK delivered second-quarter results that were in-line with our expectations, reflecting the strong efforts of our businesses in managing in a challenging global environment. Also, subsequent to the end of the second quarter, we acquired two businesses: Nu Instruments, a leading provider of magnetic sector mass spectrometers; and HS Foils, a provider of radiation detector components. Both are excellent strategic fits with existing AMETEK businesses.

I will talk further about these acquisitions in a moment, but let me first provide the financial highlights for the quarter. Sales were in-line with expectations in the second quarter at $977.7 million, down 3%. Organic sales were down 7%, while acquisitions added 4%. The impact from currency in the quarter was negligible. Operating income was $219 million, and operating income margin was 22.4%. Diluted earnings-per-share were $0.59, down 8% over last year's second quarter and at the high-end of our guidance range. Operating cash flow was very solid in the second quarter at $189 million, up 16% from last year's second quarter. Free cash flow conversion to net income was a strong 126%.

Now, turning to the individual operating groups. First, the Electronic Instruments Group. Sales of $596 million were in line with last year's second quarter. Organic sales were down 6%, acquisitions contributed 6%, and foreign currency was flat. The contributions from recent acquisitions of Brookfield and ESP/SurgeX were offset in large part by the weakness across our oil and gas business. As noted, we continue to face challenging conditions across our oil and gas business. Despite the modest rebound in the price of oil from its February lows, customers remain cautious. They continue to defer maintenance work and capital projects are being delayed. However, it appears as if conditions are stabilizing at lower levels than we previously anticipated. EIG's operating income in the second quarter was $152.1 million and operating margins were a strong 25.5%.

The Electromechanical Group reported overall sales of $381.7 million, down 6% versus the second quarter of last year. Organic sales were down 8%, acquisitions contributed 2%, and foreign currency was flat. EMG sales remained pressured by weakness across our Engineered Materials, Interconnects and Packaging businesses, driven largely by the continued headwinds from our specialty metals business. This business has stabilized; however, we do not anticipate improvements in the second half as we previously expected. EMG's operating income was $80.3 million in the quarter and operating margins were a solid 21%.

Now, let me provide background on the two acquisitions we announced this morning. First, Nu Instruments. Nu Instruments manufacturers magnetic sector mass spectrometers used for elemental and isotopic analysis. Nu's mass spectrometers utilize a magnetic field to separate the isotopes of elements in order to analyze the material characterization of a sample. Their products are used in advanced laboratory analysis within earth and environmental sciences, material characterization and nuclear applications.

Nu is an excellent strategic fit with our CAMECA advanced elemental analysis business. Nu's strong R&D capabilities and highly complementary product offering will allow us to expand our presence in existing markets while opening up opportunities to expand in new attractive market segments. In addition, Nu will be able to leverage CAMECA's strong global sales and service channels to help accelerate growth. Nu Instruments is headquartered in Wrexham in the UK, with additional offices in Beijing and Tokyo. It has annual sales of approximately $25 million.

The second acquisition is HS Foils. HS Foils develops and produces key components used in radiation detectors. These components include ultra-thin radiation windows, silicon drift detectors and X-ray filters. HS Foils is an excellent technology acquisition for AMETEK. It provides us with unique patented intellectual property around silicon nitride window technology, as well as extensive knowledge in silicon PIN and silicon drift detector manufacturing. HS Foils technology will enable world-class instrument performance across many of our materials analysis businesses, including Amptek, EDAX, SPECTRO and CAMECA. In addition, HS Foils operates out of a state-of-the-art semiconductor fab in Helsinki, Finland, which will help accelerate new product development initiatives.

With these two acquisitions, we have now deployed approximately $360 million in capital and acquired over $115 million in revenue on four acquisition so far in 2016. Our business unit and Corporate teams remain active in identifying and pursuing acquisition opportunities and we remain encouraged with the acquisition pipeline. The highest priority for capital deployment remains acquisitions.

Let me transition from highlighting our recent acquisitions to highlighting an acquisition we completed in 2013. Creaform, which we acquired in October 2013, is a leading provider of 3D measurement technologies and services. They are the industry leader in stand-alone portable 3D scanners.

Creaform's optically-based devices are used across a number of high-growth applications within the aerospace, automotive and general industrial markets. Key applications for their products include reverse engineering, dimensional inspection, precision manufacturing, automated quality control and 3D printing. Creaform has been a tremendously successful acquisition for AMETEK, with impressive results across all key financial and operational metrics. They have leveraged AMETEK's growth strategies to help deliver outstanding results.

Here are just a few of the highlights of their success. Organic sales have grown at a double-digit rate since acquisition. Operating margins have more than doubled. Working capital as a percentage of sales has improved over 700 basis points to its current level of approximately 13% of sales, and sales from new products have increased from just over 40% to now nearly 65%. This new product capability has been an important driver of Creaform's success. They have introduced a number of innovative new products, which helped them penetrate new markets and capture additional share in their existing markets.

Most recently, Creaform's new line-up of quality control solutions were awarded the prestigious Red Dot: Best of the Best Award for their quality and breakthrough designs. For over 60 years, Red Dot has been one of the largest and most influential independent product competitions in the world so this is a great honor. Specifically, Creaform's products were recognized for their unmatched accuracy and reliability of their 3D measurements in harsh and unstable production environments. The new Creaform products recognized were the HandyProbe NEXT, the MetraScan 3D, and the C-Track.

Within Global and Market Expansion, the Creaform team has done an outstanding job actively expanding and growing their strong market presence in quality control and reverse engineering into new markets, such as nondestructive testing and healthcare. Creaform has also expanded their aftermarket calibration and repair capabilities globally to help further improve their value to their customers while also leveraging AMETEK's global footprint to expand their direct sales activities in the US, Brazil, and Southeast Asia. I would like to congratulate the Creaform team for their tremendous efforts and outstanding success. They have created a truly dynamic business through the execution of our growth strategies.

Now, let me take a moment to comment on current market conditions and their impact on our outlook for 2016. We fully understand and acknowledge the headwinds we face in this environment, given our mix of end market exposures. These headwinds, especially within the oil and gas and metals markets, have been deeper and more sustained than we initially expected when we started the year. Visibility has remained limited, as customers are cautious and are aggressively managing their inventory levels and capital spending plans. As we look ahead to the balance of the year, we believe the business has stabilized.

We do not anticipate a modest second-half improvement as we had expected but rather, believe demand in the second half to be largely consistent with the first half. As a result, we now forecast 2016 revenue to be down low single-digits on a percentage basis from 2015, with organic sales down mid single-digits. We expect earnings for 2016 to be in the range of $2.28 to $2.32 per diluted share, down 9% to 11% from 2015's adjusted diluted earnings per share. Third-quarter 2016 sales are expected to be down mid single-digits versus the third quarter of 2015, and we estimate our earnings to be $0.54 to $0.55 per diluted share.

In summary, we remain focused on executing our four growth strategies despite economic uncertainty in many of our markets. We will continue to aggressively manage our business in the short-term, while ensuring we continue to make appropriate investments in our businesses to properly position us for 2017 and beyond. While we have short-term market headwinds, I am very bullish on the opportunity for AMETEK to drive meaningful earnings growth and shareholder returns moving forward. Our balance sheet remains strong, and we generate significant cash flow that provides us with plenty of liquidity to operate the business and pursue our acquisition strategy. Our businesses are highly differentiated, with strong market positions and excellent profitability. We have right-sized the cost structure and we will realize meaningful incremental margins as the current market headwinds subside. Bill Burke will now cover some of the financial details. Then we will be glad to take your questions. Bill?

Bill Burke - *AMETEK, Inc. - EVP & CFO*

Thank you, Dave. As Dave noted, our businesses performed well in the quarter, meeting our earnings expectations and generating strong cash flows despite difficult end market conditions. I will provide some of the financial highlights. In the quarter, selling, general and administrative expenses increased due to the recent acquisitions. The effective tax rate for the quarter was 27.5%, down slightly from last year's second-quarter rate of 27.7%. For 2016, we expect our tax rate to be between 26% and 27%, as a result of the success of our on-going tax planning initiatives. As we have said before, actual quarterly tax rates can differ dramatically, either positively or negatively from this full-year rate.

On the balance sheet, working capital, defined as receivables plus inventory less payables, was 19.8% of sales in the second quarter, down from 20.8% in the first quarter. Capital expenditures were $14 million in the quarter and full-year 2016 capital expenditures are expected to be $70 million. Depreciation and amortization was $41 million for the quarter and we expect full-year depreciation and amortization to be $165 million. Operating cash flow was very strong in the quarter at $189 million, up 16% over last year's second quarter.

Free cash flow was also strong at $175 million in the quarter, up 15% over last year's second quarter. As a percent of net income, free cash flow was 126% for the second quarter and we expect the full-year free cash flow to be 125% of net income. Total debt was $2.14 billion at June 30, up approximately $200 million from the 2015 year end. Offsetting this debt is cash and cash equivalents of $456 million, resulting in a net debt-to-capital ratio at June 30 of 33.4%. At June 30, we had approximately $1 billion of cash and credit facilities to fund our growth initiatives. We remain active on deploying our strong free cash flow, with our highest priority for capital deployment being acquisitions.

Subsequent to the end of the second quarter, we closed two acquisitions, HS Foils and Nu Instruments, bringing our cumulative expenditures for acquisitions in 2016 to approximately $360 million. During the second quarter, we repurchased 417,000 shares of stock for $19 million. As well, in the first several days of July, we repurchased just under 1 million shares of stock for approximately $45 million. In summary, we had a solid second quarter. We are well-positioned to support our growth initiatives with our strong balance sheet and cash flows. Kevin?

Kevin Coleman - *AMETEK, Inc. - VP of IR*

Okay, great. Thanks, Bill. Brandy, we are now happy to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Nigel Coe, Morgan Stanley.

Nigel Coe - *Morgan Stanley - Analyst*

Obviously, tough end market conditions. But if I compare the last time we had big end market declines back in 2009 to today, you held the line on margins much better then. I'm just wondering, maybe, David, if you could just maybe compare and contrast 2009 to here? What led you to keep margins pretty flat to slightly up during that period? Obviously, we're seeing a bit more pressure today.

Dave Zapico - *AMETEK, Inc. - CEO*

Right. That's a great question, Nigel. You will recall, 2009 was much different than it is in the current environment. All of the markets were down and we took action to deal with all of the markets and then it returned very quickly. But in the current environment, a couple of our markets are down. But some of our markets are hanging in there fine. So, the difference, really, it's a much slower market and the market has drug on for some time. We have a much higher margin Company, right now. If you remember that we were a mid-teens operating income margin Company, now we are much higher. The two market that are down about 20% of our Company, oil and gas and metals are down 30%. So, that's a difficult headwind to offset, but, we've done a good job to do it. We still have 22.4% operating margins and we had a good operating quarter.

Nigel Coe - *Morgan Stanley - Analyst*

Okay. No, I understand that. Then, maybe a related question, just thinking about your exports from the US. You've got a relatively high US export exposure. I'm wondering the impact of the stronger US dollar, particularly on your process business, what impact that's having on pricing within process? Maybe, on top of that, any hedge impacts on margins, would be helpful.

Dave Zapico - *AMETEK, Inc. - CEO*

Right. Yes. The question of price, across our whole business, we were up about 1 point and we had total inflation of a little less than that. So, it was still a positive contribution. We are seeing additional headwinds, as you talked about. So, we called that flat for the year, being to mean, price will offset inflation. So, it's a different environment. Our process businesses, they were very successful in expanding in the emerging markets. Also very successful in the oil and gas market. So that is one point that we're seeing issues.

Certainly, with the strong US dollar, when we're manufacturing in the US, we see competitive pressure because of the strong dollar, there is no doubt about that. We are dealing with that by relocating to low cost locations. In most situations, we don't have competitors in different market segments, that give us an advantage. But in terms of the translation and transaction effects, now we are in a relatively stable environment. We're not seeing much effect. We're naturally hedged in most of our markets. I hope those answered your questions.

Nigel Coe - *Morgan Stanley - Analyst*

Okay, so pricing flat? Or price cost plus --

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. Pricing is up 1 point across the business. Price less total inflation, that's all costs in the business is still slightly positive for the quarter. But our outlook for the year is calling price less total inflation to be flat.

Nigel Coe - *Morgan Stanley - Analyst*

Got it. Okay. Thank you.

Operator

Robert McCarthy, Stifel.

Robert McCarthy - *Stifel Nicolaus - Analyst*

A couple questions. One, I think it was customary in the past that Frank would kind of go through the state of some of the sub-segments, in terms of what we're seeing, in terms of growth and just a little bit of more color. If you could do that, kind of State of the Union, for AMETEK, right now, that would be helpful.

Dave Zapico - *AMETEK, Inc. - CEO*

Sure, Rob. I will start with EIG aerospace. EIG aerospace sales were flat as compared to the last year, as we saw continued strong growth across the commercial business that was offset by weakness in the business and regional jet market. For all of 2016, we expect a similar trend to continue as the second quarter, with the commercial market being strong and offsetting weaker business in regional jets. This business continues to deliver strong new program wins. These wins are across a wide range of platforms, including commercial OEM, business and regional jets, military. Year to date, they have already won $230 million in life of program wins. So, we're really excited about the new business we're winning in that market and you know that's important for the future of any aerospace business.

The next sub-segment will be process. Organic sales in process were down mid single-digits in the quarter, driven largely by weakness across our oil and gas business. Our ultra precision technology business performed very well in the quarter. The team has done an excellent job managing the business. For all of 2016, we expect organic sales for our process business to be down mid to high single-digits driven by the weakness in oil and gas.

Going to the EIG power and industrial sub-segment, we had overall sales for our power and industrial businesses were up double-digits, driven by the contribution of recent acquisitions of ESP/SurgeX and Brookfield. Organic sales were down mid single-digits in the quarter. For all of 2016, we expect organic sales for power and industrial to be down mid single-digits versus 2015, which is unchanged from our prior forecast. So, when you step back in 2016 for all EIG, we expect overall sales to be down low single-digits, with organic sales down mid single-digits.

If we switch to EMG, first, the differentiated parts of our EMG business, organic sales were down mid single-digits, driven largely by continued weakness across our engineered materials, interconnects and packaging business. We did see sequential stabilization in this business; however, the second-half improvements that we had anticipated are going to be delayed - and delayed out of 2016. As a result, we expect second-half sales across our EMIP business to be largely flat with the first half. For all of our differentiated EMG business, we now expect organic sales to be down mid single-digits versus the prior year.

Finally, our floor-care and specialty motors business, although a small part of AMETEK, organic sales in our floor-care and specialty motors business were down low teens in the second quarter, as a result of softer demand across our key markets. For all of 2016, we expect this business to be down mid single-digits organically, as comparisons ease through the back half of the year. So, if you look at all of EMG, we expect overall sales to be down low single-digits and organic sales to be down mid single-digits.

Robert McCarthy - *Stifel Nicolaus - Analyst*

Great.

Dave Zapico - *AMETEK, Inc. - CEO*

For all AMETEK, we expect overall sales to be down low single-digits and organic sales to be down mid single-digits on a percentage basis. Hope that helps.

Robert McCarthy - *Stifel Nicolaus - Analyst*

Yes. No, thanks for that run through. I guess, the next question, obviously, is the cadence of M&A, size of M&A. Obviously, you've deployed a fair amount of capital here. You are in an environment where -- I hate to typify -- but you have eroding fundamentals at the margin, yet very high equity valuations, which would imply high valuations for deals in both the public and private markets. So, the bid ask is really kind of nettlesome at this point. Do you think this causes a challenge to transacting deals or deals of size? How do you think about public deals? Because I think that was an area of potential opportunity for you?

Dave Zapico - *AMETEK, Inc. - CEO*

Right. You have a lot of questions there, I will try to unpack them. I think the first point is, we have four deals done this year. We deployed $360 million in free cash flow. We are about halfway through the year, so we're pretty much online for what we're doing. So, we agree that the environment is tough but we're still getting it done.

The second point is we are bullish on our pipeline. We talked about expanding our pipeline the past couple of quarters and we are starting to benefit from the efforts of those pipeline identification efforts. As you mentioned and recall, our sweet spot is that $50 million to $200 million deal. But we've expanded our horizons now, we're looking for deals up to $500 million revenue. We're looking at both private and public companies. We're really optimistic because, our pipeline is starting to reflect the efforts of the last couple of quarters, as those businesses are working their way through the pipeline.

So, in terms of acquisitions, it is a tougher environment. We are getting deals done. We have a solid pipeline. We end up parsing those deals and selecting the deals to do that we can add the most value to and we're still very selective. It is a key driver of our future value enhancement. So, I'm really optimistic. We have plenty of firepower, $1 billion of capacity within our existing credit lines and cash on hand. More importantly, our operating cash flow is $750 million. Free cash flow about $670 million. I think this can be a significant driver for the balance of 2016 and 2017 performance.

Robert McCarthy - *Stifel Nicolaus - Analyst*

Last question, if you'll indulge me. In terms of the guidance for the full year, you have visibility in your end markets in the back half and some of the inventory challenges you've had and the stabilization. But is it -- suffice it to say, you feel good about this guidance? Is it conservative? Is it unlikely we'll get another cut in the back half?

Dave Zapico - *AMETEK, Inc. - CEO*

No. There is not going to be another cut in the back half. We feel the business has stabilized. Key markets, headwinds have stabilized and our second half looks very much like our first half.

Robert McCarthy - *Stifel Nicolaus - Analyst*

I'll leave it there. Thank you.

Operator

Scott Graham, BMO Capital Markets.

Scott Graham - *BMO Capital Markets - Analyst*

Welcome to chairing your first call, Dave.

Dave Zapico - *AMETEK, Inc. - CEO*

Thank you, Scott.

Scott Graham - *BMO Capital Markets - Analyst*

Good morning, Bill, as well, Kevin. Unfortunately, it comes under not terrific auspices but I certainly did like the answer to -- or how you finished Rob's question just now. I guess, may be more surgically, I was wondering if you could tell us, what were the pressure points on the second-half effective guidance reduction here? What changed? You seemed to have a pretty good line of sight. You gave us some really good numbers in the first quarter as to why the guidance needed to come down. Could you, maybe, do something similar to that for the second half to perhaps make us feel as good as you feel about the full-year guidance, at this point?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. There's kind of two questions there. One, really what's driving the takedown and why we feel good about the stabilization. So, I'll take the first point, really, if you look at this, it can be explained really easily, economically. Our organic growth is dropping 2.5 points versus the prior forecast, so approximately $100 million. It's really driven by oil and gas and metals. That results in a 50% decremental, oil and gas is one of our most profitable businesses. So if you take that $50 million and you look at the number of shares we have, it turns out to $0.16. So that puts you right in the midpoint of the guidance range. So that's what happened, economically.

When we look out for the balance of the year, really, our EMIP business, we thought that was going to pick up and now, it's not. We could talk about that a little more in a bit. But fundamentally, we got comfortable with it because it's flat. We saw the same demand patterns in Q1 as we saw in Q2. We are forecasting that for the rest of the year. In terms of our oil and gas business, it dropped lower than we initially anticipated. We had modest improvement in that business. Now, we're forecasting it flat.

When we look at that business, we really think it's bottomed, based on what our customers are telling us, based on some of the commentary you've heard from Halliburton, Baker Hughes, Schlumberger, where rig counts bottomed in Q2. So that business is down, but we think it's bottomed. To your point, how do we get comfortable with the stability in the year? I talked a little bit about the first half being the second half, being similar. Really, embedded within our guidance, is really our Q4 is really a carbon copy of what we just did in Q2. So, we're not really forecasting a major uptick in the second half.

In fact, Q3 is down a bit, seasonally, because of some typical slowness that we've seen in Europe in the summer. We have normal seasonality in Q4. But really, Q4 is very similar to Q2. To your broader point about the forecasting and how we are accurate, how we feel more confident, many of you have followed AMETEK for quite a while. In the past, our forecasting process has yielded very consistent results. It hasn't the last few quarters. It's a difficult environment, where we have -- visibility is weak from our customers and demand is weak in many of our markets.

Customers are delaying capital projects. Customers are managing inventory aggressively. The emerging markets are challenged. But all that said, we have to do a better job forecasting that environment. I asked Bill and the Group President to take a look at our forecasting process, with a focus on making it more robust, given the environment. So, we took a different approach to forecasting. We got our entire executive office involved. We took a deep analytical review of each business to understand their forecast and to better assess potential risk.

We had conversations with the financial community, so we understood what was happening. Although, it was a more time-consuming process, we felt it was the right thing to do, at this point. It allowed our executive office -- which has the broader field of view than those of our P&L leaders running our niche businesses, who by definition, are only going to see a more narrower view of the global economy. We took that broader view. We applied a consensus view of risk that's reflected in our guidance. The final point, this is a rigorous process and I feel confident in the results.

Scott Graham - *BMO Capital Markets - Analyst*

Dave, that was very helpful. I very much appreciate that. But, obviously, the thing is that, we, with the exception of the new rigor and the new construct you have around the guidance, we did hear that in the first quarter. Oil prices are now lower again. I know it's a small business, but truck is falling apart. Then, you have Brexit potentially affecting Europe. So, if your reduction in guidance is only around oil and gas and metals is there, essentially, a lift in the cost savings number to make sure you get there? That's kind of where I'm maybe coming up short.

Dave Zapico - *AMETEK, Inc. - CEO*

Right. Yes, our cost reductions are $130 million for the year. So that's the same number that we communicated last quarter. Really, on lower volume, we are purchasing less material, but we are confirming the $130 million number. So, the cost reduction is embedded in it. You mentioned Brexit. There is a situation where we are balanced in revenues and expenses. We have 5% of our sales in the UK. We're balanced in revenues and expenses, so we have a natural hedge.

So, we're not going to have any transaction or translation surprise. So we expect the short-term impact to be minimal. We've been checking with our UK businesses on a weekly basis. We haven't seen any downturn in orders yet, mainly because we're in a market that is not maybe tied to the consumer, there. You are right, longer-term impact, it will be driven with the economic growth on the European and the global growth. This uncertainty is going to go on for some time.

But we are feeling pretty good about our exposure. There are weak global macro conditions. We highlighted oil and gas and metals. But certainly, the global economy is not good. You have the spillover effect from oil and gas into the other markets, so all the markets are tough. Again, with the first half and the second half, they are essentially carbon copies of each other and we are very comfortable with it.

Scott Graham - *BMO Capital Markets - Analyst*

All right. That's great, Dave. Thanks very much.

Operator

Allison Poliniak, Wells Fargo.

Allison Poliniak - *Wells Fargo Securities, LLC - Analyst*

Dave, I just want to go back, you said -- to sort of that metals commentary. I guess, high level, I agree we would have thought that we would've seen improvement there. Can you walk us through what happened? What changed in that business that's driving a lower expectation for the back half, now?

Dave Zapico - *AMETEK, Inc. - CEO*

Right. Sure. First, let me take a moment -- in this business, we take metals -- metals such as titanium, vanadium, cobalt, nickel, molybdenum and process them with very unique processing capabilities into specialty alloys, powders, components. We're very -- we have strong niche positions. We feel very good about this business. What's happening is, two things: visibility and inventory. In this business, we tend to be four or five levels removed from the ultimate end customer or application. So as a result, the visibility is limited. We can get misaligned with the broader end market demand, given the inventory buildup in the channel.

We're seeing this play out, right now. To give you a tangible example, we produce specialized master alloys, which is a critical component in the making of titanium parts for aircraft. We're one of the few producers who can make this specialized alloy. But we are far down removed on the food chain. So, we sell to a titanium melter, who sells to an ingot maker, who sells to a part manufacturer, who sells to a subassembly manufacturer, who eventually gets on the airframe.

So we're quite a way removed in this business, different than most of our businesses. We really -- we identified some secondary inventory locations, who had some inventory. So although the long-term demand for titanium master alloy in this case, on aircraft is very strong, with new aircraft using more titanium. The short-term demand for alloys is being impacted by this excess inventory in the supply chain.

Allison Poliniak - *Wells Fargo Securities, LLC - Analyst*

Is there any sense of when that excess inventory would be cleared?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes, it's not going to clear in 2016. But we're still bullish that's it's going to clear and it will be in 2017.

Allison Poliniak - *Wells Fargo Securities, LLC - Analyst*

Thank you. That's helpful. Then on the Nu acquisition, you had talked about expanding into new markets. Can you expand on that? Where would that -- a new market be for --

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Dave Zapico - *AMETEK, Inc. - CEO*

Yes, right. That's a great acquisition. You are talking about Nu Instruments. They have very analytical high-end magnetic sector mass spectrometers. The markets that we are in currently are similar to the markets that our CAMECA business is in: the research market and environmental -- environmental sciences, material characterization, nuclear. But the one new market that we're interested in is -- they have a new product that's in the food and beverage testing market. The interesting thing about it -- in the news, there's a lot of questions about food contamination.

The interesting thing about the Nu equipment is it's so sensitive and has a unique processing capability. It can actually tell if there is a contamination and is sensitive enough to tell where in the world the food is from. So, we are very optimistic for the food testing market. That business -- if you take a step back, the business had basically one salesperson. They have great technology. We are going to plug it into our CAMECA business, with a tremendous sales and service network. Really optimistic about the potential for Nu.

Allison Poliniak - *Wells Fargo Securities, LLC - Analyst*

That's great. Thanks so much.

Operator

Christopher Glynn, Oppenheimer.

Christopher Glynn - *Oppenheimer & Company - Analyst*

You referenced a bit of a 3Q step-down, clearly, on the EPS. Is that all volume related? What exactly drives the step-back in 3Q versus the kind of run rates for the year?

Dave Zapico - *AMETEK, Inc. - CEO*

Right. The change from Q2 to Q3 can be explained by lower sales volume. So our EPS is lower because of volume and typically, we have -- Europe had some slower months and we have seasonality in Q3 that drops it back a bit. Then Q4, there's really our normal seasonality. As I said before, Q4 is really a carbon copy of the quarter we just completed. So, we feel pretty good about it.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Okay. Makes sense. Then on the deals, I think you mentioned $150 million total sales acquired to date, disclosed Nu, if I look at the first-quarter deals. I think it all implies HS Foils is similar in size? Do I have that right to Nu?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. I think the number is wrong, it was $115 million.

Christopher Glynn - *Oppenheimer & Company - Analyst*

$115 million. Got it.

Dave Zapico - *AMETEK, Inc. - CEO*

So what you really have with Nu -- we paid a price that was a little more than 2 times sales, close to 2 times sales. It's 9 times the first-year EBITDA and HS Foils is smaller. It's significantly smaller. It's a technology acquisition that's really going to help us drive organic growth. We are optimistic about it. But it's in the low millions of dollars in terms of the technology.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Okay. That clears it up. Thanks.

Operator

Matt McConnell, RBC Capital Markets.

Matt McConnell - *RBC Capital Markets - Analyst*

Just to follow-up on the specialty metals business. I certainly understand that these end markets are fundamentally pretty healthy. Is this a permanent change in how the supply chain is managing inventory? Or are there any competitive shifts going on here that are notable? Just any permanent change in the level of activity in the specialty metals business?

Dave Zapico - *AMETEK, Inc. - CEO*

No. It's not a permanent change, Matt. It's an issue where the metals market that I talked before about the complex supply chain, it's kind of in between us and really good end markets. That market is in distress, right now. The customers are managing their inventories for cash. They're being very aggressive in terms of working capital. But long-term, we are very bullish. If you look at the titanium used in aircraft -- if you look at -- that's all growing with A350 and the 787.

If you look at the other end market applications in medical and specialized industrial, we are very bullish. Certainly, we have -- FX is creating headwinds with that business along with some of our other businesses. But there really is no competitive dynamic that's major. The market is going to return. We're going to have good business in good positions. We just have to wait it out. I talk a lot about the visibility in the inventory but that's the key factor. It is not an issue where it's not going to come back.

Matt McConnell - *RBC Capital Markets - Analyst*

Okay. Thank you. Following-up on some of the stabilization comments you made, you gave great insight around your level of conviction to that comment for oil and gas, some customer comments and actions. How about outside oil and gas? Any other -- do you have orders or backlog or any other comments that give you confidence about stabilization in the other parts of your business?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. Our backlog is $1.1 billion. When we look at the run rate, then we spend a lot of detail on it, it gives us confidence for the back half of the year. So, again, we've mentioned that the metals business is already performing from a -- in that flat sequential from Q1 to Q3. There is not much change in the other parts of our business. There's not much change in the market. You really have a slow global macro environment. The two things we've been trying to get our hands around are really oil and gas and metals. But the balance of the business is performing as we expected.

Matt McConnell - *RBC Capital Markets - Analyst*

Okay. Great. Thank you.

Operator

Richard Eastman, Robert W Baird.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Dave, or maybe this is a question for Bill, but could you just explain the decremental EBIT in EIG? Roughly, flat core sales. We delivered something like $9 million less of profit. Is that all mix shift with oil and gas being weak?

Bill Burke - *AMETEK, Inc. - EVP & CFO*

I think in EIG, we had a negative 6% core. So, what you're seeing is roughly -- I think it's a 50% kind of decremental margin in that business. You've got some of the higher-margin businesses going down. That's really what's driving the decline quarter-over-quarter in terms of the profitability in the business.

Dave Zapico - *AMETEK, Inc. - CEO*

Another point I'd add to that, Richard, really, if you think about what happened last year, our mid and downstream oil and gas businesses were still running very strong. So you have -- that business was very profitable. Now, it started down. So, that's one of the profit impacts in Q2 year-over-year.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Okay. Then I noticed from your comments, Dave, when you laid out the sub-segment expectations for sales, the cost driven motors business now, is going to be down mid single-digits versus flat. But probably more to the point, the EIG aerospace commentary suggests the second half is flat. Maybe the full year turns out to be flat versus plus low single to plus mid single. So, has there been a down-shift on the aerospace side in that regional biz jet market?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. The regional biz jet market, if you recall in 2015, we talked about some wins, some new product wins and some retrofit opportunities. This year, really, in that regional business jet, we are down about 18%. You have the -- some of the wins we talked about, if I throw a couple of examples out with Honda jet. We were designed into the Honda jet. We're making significant shipment commitments but the Honda jet has been delayed. So that market is down. We were over performing in 2015 when the market was flat, we're really, at the market levels, but dropping back. I'd point to some programs that are not repeating or are delayed.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

I see.

Dave Zapico - *AMETEK, Inc. - CEO*

The commercial market is strong and there's really no change in that. There, we have -- if you look historically, we've been mainly a Boeing airframe Company. Over the past 10 years, we've diversified our market to be even between Boeing and Airbus. So we don't care who wins. We win with both. We've got more content on newer aircraft, so even though the airframers are relatively flat, we are still growing in commercial. We feel good about that right now.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Yes. Then just one -- maybe strategic question for you, Dave. As you step in the role -- I know there's bullets flying all over the place here in terms of end market conditions. But historically, AMETEK has targeted this framework where our core businesses and our core business prospects are plus 5%. Then we're going to add 10% through M&A. But again, given where we are with the acquisitions over the last five years on the metals side, our oil and gas exposure was bigger than we had thought, perhaps.

But how do you feel about the next three to five years, targeting a core growth rate for your current mix of businesses? Should we think about that down-shifting to more of a GDP number and then will have fits and starts that, maybe, are plus or minus to GDP? Is that a more realistic view given the set of businesses and the mix of business that you have inherited and are now moving forward?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. I see your point. It's difficult to predict what's going to happen in the first few years. I did a lot of assessment of AMETEK's performance, obviously, before I got in the role and in the role. I'm a bit biased and look at our earnings growth through the cycle, the last 10 years, we grew our end 16% compounded annually. I'd give ourselves a good grade for that, an A. Margins, the same kind of thing, highest margins in the industrial space. Cash flow generation has been outstanding. Our return on capital, well in excess of our cost of capital. Our capital deployment has been excellent. We're using our free cash flows to acquire good businesses and make them better.

In my role, dealing with your question, organic growth is important. Certainly, over the next few years, when the environment can be slower, you can deal with flatter markets. Taking the current aftermarket headwinds aside, with oil and gas and metals -- but separate from that, when we return to more flattish stabilized markets, we need to adapt our strategy to the potential new reality of the marketplace. Really, when I look at it, to ensure that we're going to be able to double our earnings over the next five years by low to mid single-digit organic growth and adding on acquisitions of 5% to 10% a year. We need to do a better job with organic growth. In organic growth, we've been average. We've been average compared against some good companies. But we can definitely improve.

We can do this under the construct of our existing growth strategies and expand our operational excellence toolkit and put more tools in that toolkit to focus on our sales and marketing processes. Really, making the front-end of our business as good as our operations. That's going to be an area of focus for me and my team. It's going to take some time. It's not going to be something that moves the needle in the short term. But I'm confident it can get better.

So, we're focused on making organic growth better, to your exact question. I think in slow environment, we're going to have to boost it a little bit to get the low to mid single-digit organic growth that allows us to double the earnings of the Company.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Okay. All right. Thank you.

Operator

Andrew Obin, Bank of America.

Akshay Bhatia - *Bank of America - Analyst*

This is actually Akshay Bhatia on for Andrew. I just wanted to dig into your energy exposure a little bit. Could you remind us what your exposure is between upstream, midstream and downstream after a couple of years of downturn? Could you talk about some of the trends you saw over the course of the quarter? Maybe how April compared to June across these different business lines?

Dave Zapico - *AMETEK, Inc. - CEO*

It was difficult to hear you, but I think I have your questions. The oil and gas business, as we talked before, was lower than forecasted in Q2, but stabilized. So we saw orders in that second quarter that really matched our Q3 volume level. So we feel good about that. Coming into the year, it was about a $360 million business from AMETEK, about one-third of that is upstream, one-third of that is midstream and one-third is downstream.

The business is one-third US and two-thirds international. We have $120 million take down this year, so the $360 million is going to be down $120 million. That's about one-third. It's about $60 million down in upstream and $60 million down in the combination of mid and downstream. So, if you look at our upstream exposure, that's down about 60% and our mid and downstream exposure's about 20%.

Akshay Bhatia - *Bank of America - Analyst*

I know you talked about pricing overall being up 1%. But could you discuss pricing that you're seeing specifically in the energy market?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. The pricing in the energy market is below the average for the whole Company. It's a very difficult environment. They have had to reduce cost to stay in business. We still can maintain pricing because we have very premier positions with niche differentiated technologies, but it's certainly not at the AMETEK level, on average. We are down a bit in the energy market, more in the upstream than the mid and downstream.

Akshay Bhatia - *Bank of America - Analyst*

Thank you.

Operator

(Operator Instructions)

Bhupender Bohra.

Bhupender Bohra - *Jefferies LLC - Analyst*

Just on the orders growth, could you give us the number and organically what the orders growth were for EIG and EMG in the quarter?

Dave Zapico - *AMETEK, Inc. - CEO*

Sure. Organic orders were minus 7%, so that was in line with sales. Our EIG organic orders were down 5%. EMG organic orders were down 9%.

Bhupender Bohra - *Jefferies LLC - Analyst*

Okay. We've been talking about products and the end markets. I just want to focus on the geographic mix here. If you can give us some color, how the emerging markets did, actually, in the quarter? Because oil and gas is like two-third is international. Just wanted to get a sense of how it did in Europe, Asia-Pacific and outside the US too?

Dave Zapico - *AMETEK, Inc. - CEO*

Sure, Bhupender, I'll go around the world. In the US, we were down high single-digits versus last year. There was broader industrial weakness but the key factors driving the negative growth were oil and gas and metals. In Europe, it was down low single-digit, so we've been at that level for several quarters. Oil and gas impacted the region. But we don't have much metals exposure in Europe.

In Asia, we were down mid single-digits. China was down mid single-digits. So, there was a little bit of an improvement in China, it was a better trend for Asia. We were down double-digits for three quarters in a row. Now, we are down mid single-digits. China was a negative 4%. Orders for the region, the entire Asia region, were a little bit better than the prior year, so it seems to be that Asia is stabilizing. China is stabilizing. The one emerging market that I'd point out that's doing better than the others, is India, that we have aboutmid single-digit growth in India. It's a much smaller exposure, but our investments there are paying off.

Bhupender Bohra - *Jefferies LLC - Analyst*

How should we think about how these markets would act, or what kind of assumptions you have for the second half? Which of these markets would be remaining stable or along the lines you just mentioned, or they would be delayed further?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. If I look at the trends in the US, even though we are down high single-digits, it's slightly better from last quarter. Europe, that same trend is continuing. In Asia, we are improving a bit but really it's -- we don't have anything factored in. It's really a down mid single-digit. Geographic wise, it is squared with our concept of stabilization. Fundamentally, our business has stabilized. We are working on earnings growth for 2017, now. We're focused on our business. We are getting ready to go into our budgeting process.

That budgeting process that we go through in Q3 and spreads into Q4, there's really no area immune from efficiency improvement. We're going to look at things like global sourcing, low-cost region production, value analysis, value engineering, plant consolidations, all the tools that we have and we are going to get a healthy cost reduction target. We're going to pair that with acquisitions. That's how we're going to grow earnings next year. So, geography is not a big factor in thinking through what we have to do for the balance of the year or what we have to do next year.

Bhupender Bohra - *Jefferies LLC - Analyst*

Okay. If I go back a few quarters here, when Frank was there, he did mentioned that AMETEK could actually grow their margins by 30 to 40 bps, I believe, if I'm right, even in a declining organic growth sales [par]. Now, how should we think about the back half of this year? Are we -- any assumptions here? Will the focus will be more on the cost side as the macros -- (multiple speakers).

Dave Zapico - *AMETEK, Inc. - CEO*

Right. For the year, we're saying operating income margins will be down 130 to 170 basis points. Longer term, given all the -- given our high margin contribution margin businesses and given our operational excellence capabilities, as far as the eye can see, when we get out of these market conditions and we return to internal growth, we have the same 30 bp of margin expansion, for the long-term.

Bhupender Bohra - *Jefferies LLC - Analyst*

Got it. Okay. Got it. Lastly, just wanted to tap into your oil and gas. You just gave the number of $360 million impact, Company-wide is that the direct exposure? Or --

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Dave Zapico - *AMETEK, Inc. - CEO*

Yes. That's direct exposure, it's not indirect exposure.

Bhupender Bohra - *Jefferies LLC - Analyst*

Right.

Dave Zapico - *AMETEK, Inc. - CEO*

So, obviously, some impact in other markets that are not oil and gas related. But that's a direct exposure and that will be down about $120 million this year.

Bhupender Bohra - *Jefferies LLC - Analyst*

Right. That's what I just wanted to get a sense of because when we think of AMETEK, we think of oil and gas to be about -- less than 9% of total sales, which is about $360 million, which you just gave.

Dave Zapico - *AMETEK, Inc. - CEO*

Right.

Bhupender Bohra - *Jefferies LLC - Analyst*

But when we look at indirect exposure, like within EMIP and some other markets where oil and gas is definitely one of the markets where you are serving, I don't know if you have done some work internally to give us a sense of what the indirect exposure would be?

Dave Zapico - *AMETEK, Inc. - CEO*

Yes. The total market exposure for AMETEK -- most of it is in process, but the total market expansion for AMETEK exposure, going into the year was $360 million. That's the entire exposure. I was talking about the indirect exposure, for example, you look at the helicopter market. They used to use helicopters to fly to offshore platforms, so there's less demand for helicopters. That's in our business jet and regional jet segment, that's where we report it. So, when I was talking indirect, I was talking that. The total oil and gas exposure is the $360 million.

Bhupender Bohra - *Jefferies LLC - Analyst*

Okay. Got it. Thank you.

Operator

There are no further questions at this time. I will now turn the call back over to Mr. Kevin Coleman. Please, go ahead.

Kevin Coleman - *AMETEK, Inc. - VP of IR*

Okay. Thank you, Brandy. Thanks everyone for joining the call today. As a reminder, a replay of the call can be accessed at AMETEK.com and streetevents.com. As always, we're available for additional calls and questions this afternoon. Thank you.

Operator

This concludes today's conference call. You may now disconnect.
