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AME - Q3 2016 Ametek Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 01, 2016 / 12:30PM GMT

OVERVIEW:

Co. reported 3Q16 sales of $945m and diluted EPS of $0.56. Expects 2016 revenue to be down low-single digits on a percentage basis from 2015 and diluted EPS to be $2.29-2.31. Expects 4Q16 sales to be down low-single digits vs. 4Q15 and diluted EPS to be $0.57-0.59.

CORPORATE PARTICIPANTS

Kevin Coleman *AMETEK Inc - VP of IR*

Dave Zapico *AMETEK Inc - CEO*

Bill Burke *AMETEK Inc - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Scott Graham *Jefferies & Company - Analyst*

Matt Summerville *Alembic Global Advisors - Analyst*

Allison Poliniak *Wells Fargo Securities - Analyst*

Bhupender Bohra *Jefferies & Company - Analyst*

Brett Linzey *Vertical Research - Analyst*

Christopher Glynn *Oppenheimer & Company - Analyst*

Nigel Coe *Morgan Stanley - Analyst*

Robert McCarthy *Stifel Nicolaus - Analyst*

Andrew Obin *BofA Merrill Lynch - Analyst*

Tristan Margot *Cowen and Company - Analyst*

PRESENTATION

Operator

Good morning. My name is Brent, and I will be your conference operator today. At this time, I would like to welcome everyone to the AMETEK third-quarter 2016 earnings conference call.

(Operator Instructions)

I'd now like to turn the call over to your host, Kevin Coleman, Vice President of Investor Relations. Please go ahead, sir.

Kevin Coleman - *AMETEK Inc - VP of IR*

Great, thank you, Brent. Good morning, and thank you for joining us for AMETEK's second-quarter earnings conference call -- I'm sorry, third-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 third-quarter results were released earlier this morning and are available electronically on market systems and our website at the Investor 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 want to 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 will also refer you to the Investor section of Ametek.com for a reconciliation of any non-GAAP financial measures used during this conference call.

We will begin today with prepared remarks by Dave and Bill, and then we will open it up for questions. I will now turn the meeting over to Dave.

Dave Zapico - *AMETEK Inc - CEO*

Thank you, Kevin, and good morning.

AMETEK performed well in the third quarter, with results in line with our expectations. We feel business conditions across our most challenging markets are beginning to stabilize. Although we remain cautious about the short-term demand environment, we are encouraged with this stabilization. Also, I am pleased to announce that subsequent to the end of the third quarter, we acquired Laserage Technology, a provider of laser-based fabrication services to the medical device industry, in an excellent fit with our engineered medical components business. With this acquisition we have now acquired five businesses so far in 2016, and have deployed approximately $390 million in capital. We also deployed approximately $100 million on share repurchases during the third quarter. To support our capital deployment activities, we announced today that we entered into a private placement agreement to sell the equivalent of approximately $825 million in senior notes at attractive rates. We will provide more detail on the recent acquisition and our private placement later. But as these activities show, AMETEK remains committed to the disciplined deployment of capital.

Now let me provide the financial highlights for the quarter. Sales were in line with our expectations in the third quarter at $945 million, down 5% versus the third quarter of 2015. Organic sales were down 8%, while acquisitions added 3%. The impact from foreign currency in the quarter was negligible. Operating income in the quarter was $201.1 million, and operating income margin was 21.3%. Diluted earnings per share were $0.56, down 14% over last year's third quarter.

Now turning to the individual operating groups. First, Electronic Instruments Group. Sales of $579.3 million were down 3% versus last year's third quarter. Organic sales were down 8%, acquisitions contributed 5%, and foreign currency was flat. The strong acquisition growth was driven by the contributions from the recent acquisitions of Brookfield, ESP/SurgeX, Nu Instruments, and HS Foils. The organic sales decline was driven in part by weakness across our oil and gas markets. Results for our oil and gas businesses were as expected, with conditions beginning to stabilize across each of our upstream, midstream, and downstream businesses. EIG's operating income in the third quarter was $142.7 million, and operating income margins were 24.6%.

The Electromechanical Group reported overall sales of $365.7 million, down 9% versus the third quarter of last year, with organic sales down 7%, and foreign currency a 1% headwind. The largest driver of the sales weakness was our Engineered Materials, Interconnect, and Packaging businesses. This business has also begun to stabilize, and we expect to see similar conditions in the fourth quarter as we saw in the third quarter. EMG's operating income was $71.4 million in the quarter, and operating margins were 19.5%.

Now let me provide some background on the acquisition we announced this morning. Laserage is a leading provider of laser fabrication services to the medical device market. They offer precision tube fabrication of minimally invasive surgical devices, stents, specialty catheters and catheter-based delivery systems. They also have excellent design capabilities for medical devices. Laserage is an excellent addition to our growing presence in the medical industry. It is a great strategic fit with our engineered medical components business, as it provides excellent market and technology synergies. In addition, the business operates in markets and applications with strong growth characteristics. Laserage [was family-] held, is headquartered in Waukegan, Illinois, with a manufacturing facility in Milpitas, California. Laserage has annual sales of $22 million. I would like to welcome the team from Laserage to AMETEK.

We remain very active in identifying and executing highly strategic acquisitions across our businesses. The pipeline of acquisitions remains very solid, and our teams continue to do an outstanding job of supporting our M&A efforts. In addition to our continued focus on investing in strategic acquisitions, we continue to make investments to afford long-term organic growth. In particular, we continue to make sizable investments in research, development, and engineering, and in 2016, we expect to invest $205 million or 5% of sales.

I want to highlight just a few of our recent new product introductions. Our Solartron Analytical business, a global leader in electrochemical impedance spectroscopy for materials and electrochemical research, has added four new application-specific instruments to their Apps-XM series of laboratory instruments. The XM stands for extreme measurement, and each new instrument was developed with specific capabilities for highly targeted research applications. Each occupies less than half the footprint of similar laboratory instruments and provides increased measurement performance. These instruments are used for testing energy storage devices such as batteries, supercapacitors, and fuel cells, as well as for testing materials used in photovoltaic and solar cell applications.

AMETEK Aerospace & Defense developed a patent-pending exhaust gas thermocouple with a sheath made from an advanced ceramic matrix composite. The thermocouple is used to measure temperature and jet engine exhaust gases, and its highly advanced ceramic matrix sheathing extends the thermocouple's high-temperature performance range. This sheathing material is one-third Estance steel and nickel alloys, exhibits better performance than pure ceramic materials, and extends the life of a thermocouple, helping to postpone costly jet engine overhauls.

Our Vision Research business, which is a leader in high-speed imaging systems, unveiled its new family of Phantom VIO high-speed cameras. These compact, rugged cameras are designed for a wide range of applications, including scientific analysis, material testing and defense research. The VIO family includes eight individual models across four performance levels, and two body [spouts], providing users with flexibility for their specific needs. These high-speed, high-resolution cameras are packed full of features in a 5-inch cube that is designed for durability and will stand up to 100 Gs of force.

These investments in research and development, combined with our strong engineering talent across the Company, are driving excellent new product development results. Revenue from new products introduced over the last three years, our vitality index, was an excellent 25% in the quarter.

We also remain focused on driving our Operational Excellence strategy. Our teams are doing an excellent job driving continual operational improvements through their businesses by leveraging our Operational Excellence toolkit. Overall, in 2016, we expect to generate $130 million in total Operational Excellence savings. These Operational Excellence activities include lean manufacturing, global sourcing and strategic procurement, value analysis and value engineering, design for Six Sigma, and the movement of production to low-cost locales. These OpEx initiatives also include various tools that are focused on the front end of our business. As I noted last quarter, we are focused on leveraging and broadening tools in this area across all of our businesses to ensure we are properly positioned for long-term growth.

Now I will turn to the outlook for the balance of the year. Our expectations remain unchanged for the year. We continue to expect 2016 revenue to be down low single digits on a percentage basis from 2015, with organic sales down mid single digits. We have tightened our guidance range for 2016 to a range of approximately $2.29 to $2.31 per diluted share, leaving the midpoint of the guidance unchanged at $2.30. Fourth-quarter 2016 sales are expected to be down low single digits versus the fourth quarter of 2015, with earnings of approximately $0.57 to $0.59 per diluted share.

In summary, we delivered results that were in line with our expectations. We have reaffirmed our full-year sales guidance and the midpoint of our earnings guidance. We have acquired five high-quality businesses in 2016, and our pipeline of acquisition opportunities is excellent. We generated strong free cash flow, and have the balance sheet flexibility to continue to acquire [free] businesses. We remain focused on aggressively managing our businesses in the short term, while ensuring we make appropriate investments to properly position us for 2017 and beyond. We have a deep and talented management team that will continue to execute our four growth strategies. I'm very bullish on the future of AMETEK and believe we all are well-positioned to drive meaningful earnings growth and shareholder returns moving forward.

Bill Burke will now cover some financial details and provide more information on our private placement. 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 third quarter, with solid results that met our expectations. I'll provide some of the financial highlights. In the quarter, organic selling expenses were down roughly in line with organic sales on a percentage basis. General and administrative expenses were up over last year's third quarter on higher consulting costs. The effective tax rate for the quarter was 25%, down from last year's rate of 26.1%. We continue to expect our tax rate for 2016 to be between 26% and 27%. As we've said before, actual quarterly tax rates can differ dramatically, either positively or negatively, from this full-year rate.

Working capital, defined as receivables plus inventory, less payables, was 20.8% of sales in the third quarter. Capital expenditures were $15 million for the quarter, and we expect full-year capital expenditures to be approximately $70 million. Depreciation and amortization expense in the quarter was $42 million. And for the full year, we expect depreciation and amortization to be approximately $165 million.

Operating cash flow was $169 million in the quarter. And free cash flow was $154 million, representing 118% of net income. For the full year we expect free cash flow to be a strong 125% of net income. We've been very active deploying our free cash flow this year. In the third quarter, we deployed approximately $65 million on the acquisitions of new instruments in HS Foils. And subsequent to the end of the quarter, we deployed approximately $32 million on the acquisition of Laserage. These acquisitions bring our cumulative expenditures for acquisitions in 2016 to approximately $390 million. In addition, during the third quarter we repurchased 2.2 million shares of our stock for approximately $100 million. The highest priority for our cash flow remains acquisitions. However, as we have shown, we will look to opportunistically deploy our cash flow on share buybacks.

Total debt at September 30 was $2.15 billion, up approximately $200 million from the 2015 year end. Offsetting this debt is cash and cash equivalents of $445 million, resulting in a net-debt-to-capital ratio at September 30 of 34%. At September 30, we had approximately $1 billion of cash and credit facilities to fund our growth initiatives.

As we announced this morning, we entered into a private placement on October 31 to sell the equivalent of approximately $825 million in senior notes. We're issuing EUR500 million and GBP225 million, all with maturities ranging from 10 to 15 years. The proceeds of this offering will be used to pay down our revolver balance and to repay a GBP40 million note due later this month. The private placement was well-received by our lenders. Overall, this issuance had a weighted average interest rate of 1.82%, and a weighted average maturity of 11.5 years. This offering provides AMETEK with a larger financing capacity and increased flexibility to support our growth initiatives.

In summary, our businesses managed very well in the third quarter in the face of challenging market conditions. We remain active in deploying capital, and are well-positioned to support our growth initiatives with our strong balance sheet and cash flows. Kevin?

Kevin Coleman - *AMETEK Inc - VP of IR*

Great, thank you, Bill. Brent, we would like to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Scott Graham, BMO Capital.

Scott Graham - *Jefferies & Company - Analyst*

Hi, good morning. Can you hear me?

Dave Zapico - *AMETEK Inc - CEO*

Yes. Hi, Scott, good morning.

Scott Graham - *Jefferies & Company - Analyst*

Good morning to all, thank you. Could you just talk about the tone of sales as the third quarter progressed? And maybe give us kind of the same on order rates? Maybe also tell us the organic order rate change in the quarter?

Dave Zapico - *AMETEK Inc - CEO*

Sure, Scott. I'll start with sales. Overall, sales came in, in line with our expectations. We said we would be down mid single-digits, and we were down 5%. And so it's right on. Organic sales were down close to 7.5%, which was very close to our expectations.

We did see some [winter] growth in our Aerospace segment, mainly because of the business in regional jet markets slowed a bit. But it was a bit stronger growth in our Ultra Precision Technologies business. So when you look at the whole picture, during Q3, it played out largely as we expected. If you recall, we did a deep dive at the end of the second quarter to re-forecast, and it turned out exactly as we thought.

In terms of orders, the organic order rates in the quarter were minus 3.5%. The organic sales were down 8%. So we got some momentum. Book-to-bill was 1.02, and the orders trended up in the quarter. So we're feeling good going into Q4.

Scott Graham - *Jefferies & Company - Analyst*

Very good. And that typical analysis that Frank did and then you kind of jumped in on last quarter, Dave, would you mind doing that in sort of the divisional analysis?

Dave Zapico - *AMETEK Inc - CEO*

Yes, sure, Scott. Overall, Aerospace sales were down mid single-digits in the quarter. We continued to see strong growth in our commercial OEM business. We won excellent content across a wide number of next-generation commercial aircraft platforms, and we are really well-positioned to benefit from this continued growth.

Our business in regional jet business continues to be weak. And the military was down a bit in the quarter due to program timing. So for all of 2016, we expect Aerospace sales to be down low single-digits. So the growth in our commercial OEM businesses is offset partially by weakness in the business of regional jets.

Jumping into the Process segment, organic sales in Process were down mid single-digits in the quarter. This was in line with our expectations, and driven by weakness across our oil and gas businesses. We did see stabilization within our oil and gas businesses during the quarter, as we expected, and we expect this stabilization to continue through the fourth quarter.

Our Ultra Precision Technologies, our EPT business, again had a very strong quarter, with good growth across their businesses. And as a result of new product rollouts and global and new market expansion initiatives, it was a very positive quarter. For all of 2016, we continue to expect organic sales for our Process businesses to be down mid to high single-digits, driven largely by oil and gas.

Our sales for our Power and Industrial businesses were up mid-single-digits in the quarter, driven by contributions from acquisitions ESP/SurgeX and Brookfield. Organic sales were down low double-digits in the quarter, driven by a difficult prior-year comparison. And 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.

Organic sales for our differentiated EMP businesses were down mid single-digits, driven largely by weakness across our Engineered Material, Interconnect & Packaging business. We are starting to see stabilization in this business also, as expected, like oil and gas. For all the differentiated EMG, we continue to expect organic sales to be down mid single-digits versus the prior year.

Floorcare & Specialty Motors, the last segment of smaller segments, organic sales were down high single-digits in third quarter, driven by softer demand across key markets. And for all of 2016, we expect sales for this business to be down mid single-digits organically, unchanged from the previous expectations.

When you look at it from the Group level, for all of the EIG, it's unchanged from prior guidance we provided last quarter. We continue to expect overall sales to be down low single-digits, with organic sales down mid single-digits. To the same for EMG, it's the same as prior guidance we provided last quarter, with both overall and organic sales down mid single-digits. And for all of AMETEK, our guidance remains unchanged, with overall sales expected to be down low single-digits, and organic sales down mid single-digits.

Scott Graham - *Jefferies & Company - Analyst*

Very good, Dave. Thanks very much for your time.

Dave Zapico - *AMETEK Inc - CEO*

Thank you, Scott.

Operator

Matt Summerville, Alembic Global Advisors.

Matt Summerville - *Alembic Global Advisors - Analyst*

Hey, good morning.

Dave Zapico - *AMETEK Inc - CEO*

Good morning, Matt.

Matt Summerville - *Alembic Global Advisors - Analyst*

A couple of follow-ups on the oil and gas side of things. Can you size that business for us today in terms of where you think it comes in overall for 2016? And not just in EIG, but also, if you want to call it your collateral exposure that you have in other parts of the businesses? And then, are you able to put some numbers around the point you're making that you are seeing stabilization? Can you kind of walk us through how that business has maybe progressed to get you to that conclusion? Thank you.

Dave Zapico - *AMETEK Inc - CEO*

Right. Yes, I'll start with entering the year, the oil and gas presence for AMETEK was about $360 million, and that is across our entire business. The majority of that is in electronic instruments, though, in our Process segment. As the year played out, that business is going to be down about 33%, or down about $120 million.

We had a 60% decline in our upstream business and a 60% decline in our mid and downstream businesses. So if you go back to at the peak, our upstream sales are down about 70%, tied to the rig count decline. And our midstream and downstream businesses are down about 20%, driven by cuts in capital spending and delayed maintenance work.

So we saw the peak in 2014. We saw an initial decline in our upstream business. We got into -- in 2015, we saw an initial decline in our upstream business. In 2016, we saw the continuing decline in the upstream, and then flowing through the midstream. And it went up/down about a third again. We're about $240 million coming out of 2016.

We look at it -- when I feel good about it, one, I look at the order rates. The order rates for businesses are supporting a flat Q4, largely in the, I'd say, a longer backlog business, with some short-term MRO business. But I feel good about the backlog we have entering the quarter.

When I think about the beginning of the year, we were down large percentages in oil and gas -- 35% in Q1, about the same in Q2. In Q3, we are down about 20%, and we think that will continue until we are down even less in Q4. So the sequential run rates in the business definitely have stabilized, our order rates have stabilized, and I think we took a good look at it at the end of Q2, and it feels the same right now.

Matt Summerville - *Alembic Global Advisors - Analyst*

Great, thank you.

Dave Zapico - *AMETEK Inc - CEO*

Thanks.

Operator

Allison Poliniak, Wells Fargo.

Allison Poliniak - *Wells Fargo Securities - Analyst*

Hi, guys, good morning.

Dave Zapico - *AMETEK Inc - CEO*

Hi, Allison.

Allison Poliniak - *Wells Fargo Securities - Analyst*

I know you talked about maybe military spending spilling over, but has there been any noted changes in customer buying patterns? I know you're comfortable with orders. But just do you feel like anything is getting deferred into next year as we are sort of close to exiting 2016 at this point?

Dave Zapico - *AMETEK Inc - CEO*

No, I don't really feel that way. I mean, in the quarter, we did see some additional weakness in our business jet business. And there were some, on the military side, some programs that were some timing issues. But in general, we didn't see much change in the ordering patterns. The orders accelerated through the quarter, and we feel well-positioned for Q4.

Allison Poliniak - *Wells Fargo Securities - Analyst*

Great. And then just thanks for the color on oil and gas. But as we look, things have stabilized. How should we think of your business, or the flow-through to your business, if we start to see activities start to improve as we enter 2017, for you guys?

Dave Zapico - *AMETEK Inc - CEO*

Yes, we haven't done our planning for 2017 yet, so we're not going to have too much guidance on that. But I think what we're seeing is, rig pounds have started to pick up, activity is beginning, the market is starting to come back in equilibrium. That will continue through 2017. Certainly in 2017, we aren't going to have the same headwinds that we had this year.

And we're going to sit down with our business during our budgeting cycle and -- all of businesses during our budgeting cycle -- during the next few weeks, and get a real good feel for what's going on. And we're going to communicate that guidance to you in our Q4 earnings call. But it really played out as expected. And going into next year, we will find out. But we certainly aren't going to expect the headwinds that we had.

Allison Poliniak - *Wells Fargo Securities - Analyst*

Great. I guess I'm asking -- I mean, is there a certain lag effect that we should expect for you guys? Traditionally, historically, what have you experienced when you've come out of something like this?

Dave Zapico - *AMETEK Inc - CEO*

Yes, I think there is -- you really have a situation where there's excess capacity built up in the industry, and that excess capacity has to be utilized. So there may be a bit of a -- if you look at our upstream business, that business typically, long term, follows the Baker Hughes drilling rig index. But it doesn't follow it directly. Usually the rigging index ticks up, and then we will follow as capacity [issues]. So there could be a lag. And I think during 2017, that will play out.

So again, we're going to get detailed insight from our businesses. But one thing that we are sure of is that any small increase in organic growth, we have leaned the cost structure of these business out. These businesses are very well-managed, they have strong market positions, high market share in our oil and gas businesses, and we're poised to capitalize on any market growth when it returns. But we're not forecasting any right now.

Allison Poliniak - *Wells Fargo Securities - Analyst*

Great, thank you.

Dave Zapico - *AMETEK Inc - CEO*

Thank you.

Operator

Bhupender Bohra, Jefferies.

Bhupender Bohra - *Jefferies & Company - Analyst*

Hey, good morning, guys.

Dave Zapico - *AMETEK Inc - CEO*

Good morning, Brupender.

Bhupender Bohra - *Jefferies & Company - Analyst*

So just on the geographic, wondering if you can give the growth in different geographics around the world? And especially, can you remind us how much BRIC is for AMETEK in terms of sales, and how those regions actually performed in the quarter? Thank you.

Dave Zapico - *AMETEK Inc - CEO*

Sure, glad to do that. I'll start with the US. We were down low double-digits versus the prior year. It was driven by broad industrial weakness, but the key factors driving the negative growth were oil and gas and metals. And if you look at the trend, it's really been that way for the last three quarters. We've had about low double-digit 10% decline the last three quarters. So it stabilized at that level.

If we jump over to Europe, it was down low single-digits, in line with recent trends there. We've been down low single-digits for the better part of a year.

Asia was a 1% positive; it was up 1% organically. If you think back over the past year, year and a half, it was down low double-digits and down low double-digits, down 10%, down mid single-digits, sequentially in quarters. Now it is up 1%. And China, the biggest driver in Asia, was down slightly. So it was down about 1%. So we feel pretty good about Asia. We had good performance in Japan and Korea and some other markets. So it was up 1% organically.

When you go to the BRIC countries, now, overall, the BRIC countries are 11% of sales. We've been very successful historically in the BRIC countries, but the emerging markets are challenged right now. Our emerging market exposure is dominated by China -- so, largest by far. And as I already mentioned, we were down 1%. But when you look at places like Brazil and Russia, they were down very significant double digits, 20%-plus in each of those markets.

And India has been a different story. It has been growing at mid-single-digit rates. This quarter, it was a little different; it was down a bit, about 20%. But that's more from large program orders. We don't really have a base business in India yet, but it will bounce around. But I really see that trend continuing. So basically, in BRIC countries, we have China stabilized -- that's the biggest market -- India on a slow growth path, and Brazil and Russia in the dumps.

Bhupender Bohra - *Jefferies & Company - Analyst*

Okay, got it. I know you gave the organic growth orders with your -- can you give the orders growth rate for EIG and EMG on a core basis?

Dave Zapico - *AMETEK Inc - CEO*

Yes, I'll go through the whole orders profile for you. We booked out $964 million of orders in the quarter. The total orders were down 2%. As I mentioned earlier to Scott, the organic orders were down 3.5%. EIG organic orders were down 5%. And EMG organic orders were down 1%.

Bhupender Bohra - *Jefferies & Company - Analyst*

Okay, got it. And lastly, on the [emis] business, you said the business had stabilized quarter to quarter. Now can you give us some insight into the de-stocking that you had seen over the last three quarters in that business, especially on the metal side, how that is progressing and where we are with that? Thank you.

Dave Zapico - *AMETEK Inc - CEO*

Yes, we continue to expect sales will be down roughly $125 million. It's about 25% in 2016. But the year-over-year declines will moderate in Q4 due to easier comps, so we're seeing stabilization begin in the market. The pricing trends -- we talked about the pricing trends for key metals we have exposure to, are mixed, with some increasing, like nickel and vanadium, over the last quarter, and some decreasing, like molybdenum and titanium. So that's mixed.

As I mentioned last quarter, and to your point, our visibility into inventory levels within this market, this channel, is limited. But it's largely playing out as expected. We are seeing orders coming from inventory-depleted businesses/customers, and we're not seeing orders in other places where the inventory is still there. So we're certainly not saying the inventory destock is complete. But we are seeing enough order rates to be comfortable that our fourth quarters is going to be a lot like our third. And that's our forecast for emis.

Bhupender Bohra - *Jefferies & Company - Analyst*

Thanks, Dave.

Dave Zapico - *AMETEK Inc - CEO*

Sure.

Operator

Brett Linzey, Vertical Research.

Brett Linzey - *Vertical Research - Analyst*

Hi, good morning, all.

Dave Zapico - *AMETEK Inc - CEO*

Good morning.

Brett Linzey - *Vertical Research - Analyst*

Just wanted to come back to the comments regarding business stabilization. It sounds like the optics of the easing comps is helping that narrative. Are you seeing an actual fundamental inflection in the tone in those businesses, or is it more an element of comparisons? And then, any early view on 2017 expectations as you see some of these headwinds abate?

Dave Zapico - *AMETEK Inc - CEO*

Yes, the first point is, you are correct, we are seeing easier comps as we progress through the year. But in our last call, we spent a lot of time comparing the second half of the year to the first half of the year, and they were essentially carbon copies of each other. So along with the easier comps, the business has stabilized, because the second half of the year, we are going to do very similar to the volume and profitability that we did in the first half.

Regarding 2017, I'm just not going to give guidance right now. We typically don't give it until we release our fourth-quarter earnings. We have a very fulsome budget process, where Bill and I sit down with each of our business units -- we have a very detailed process that we work through. Certainly we're not expecting a major change in the global macro environment. We will be focused on driving cost reduction to our Operational Excellence activities, but we are not going to comment on it until we get to the fourth-quarter earnings.

Brett Linzey - *Vertical Research - Analyst*

Okay. And then just with regards to the private placement offering, it sounds like a smart transaction there. Do you expect any interest savings? And then I guess as you look at available cash and free cash flow generation, and the new capacity it provides, how should we think about that capacity over the next 12 months, with this new arrangement?

Bill Burke - *AMETEK Inc - EVP & CFO*

Yes, I think from -- this is bill Burke, I think from a interest rate perspective, certainly the rate that we're talking about is very close to the revolver rate that we are paying, which is about 1.7% before any Fed action. So I think it's pretty much of a wash from that perspective. But what it really does is, it gives us a lot of capacity to go after -- in terms of capital deployment, in particular, going after acquisitions.

So I think it's really just a retooling of that capacity. And if you think about it, we took short-term debt and put it out for 11.5 years at essentially the same interest rate. So it was a no-brainer from that perspective. But I think most importantly, it also gives us the capacity to continue our capital deployment.

Brett Linzey - *Vertical Research - Analyst*

And would you be able to maybe size that incremental capacity that it does provide?

Dave Zapico - *AMETEK Inc - CEO*

Sure. We have -- with cash and unused revolver capacity, we have approximately $1.5 billion of firepower to go at acquisitions. So we're pretty pleased with that. We've got a strong balance sheet, and we're looking to deploy it. We have a great pipeline of deals, and we're aggressively working at a lot of them.

Brett Linzey - *Vertical Research - Analyst*

Great, thanks, guys.

Operator

Deane Dray, RBC. Would you please make sure that your line is not on mute?

Kevin Coleman - *AMETEK Inc - VP of IR*

Brent, why don't we go to the next caller? We can get back to Deane.

Operator

Christopher Glynn, Oppenheimer.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Thanks, good morning.

Dave Zapico - *AMETEK Inc - CEO*

Good morning, Chris.

Christopher Glynn - *Oppenheimer & Company - Analyst*

So I think the outlook for the year is up low single-digits. That really implies the absolute sales in the fourth quarter is up meaningfully from the third. Otherwise, we are really talking about down mid single-digits reported for the year. So I'm just wondering where you see the volumes ramping sequentially -- what the dynamics are?

Dave Zapico - *AMETEK Inc - CEO*

Sure, Chris. There is a ramp on our sales from 3Q to 4Q, as you mentioned. We typically see a sequential ramp from quarter-three, so the increase was as expected. And it's largely driven by the normal seasonality patterns that we expect to play out on our businesses. The places where our business -- or, as seasonality plays out, is our process businesses. And we are seeing those order entry rates indicate that, that is going to happen. A little bit of our power business has a bit of seasonality.

So when you look across our portfolio, we have businesses that have a bit of seasonality. It's built into the forecast. And as I mentioned last quarter, our Q4 is a lot like our Q2. So we don't have anything heroic forecasted, just a typical sequential ramp-up due to seasonality.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Yes, it's interesting because a lot of companies have talked about kind of not seeing the seasonality into year-end. So is there anything kind of lumpy that's helping with that bridge?

Dave Zapico - *AMETEK Inc - CEO*

No, I don't think so. If we get to our organic order rates, our organic sales in Q3 were, as I said, down about 7.5%. And our orders were down about 3.5%. And we have a little ramp to get through, but it's very similar to what we did in Q2.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Okay. And then maybe try to sidewalk around the version to 2017 comments at this point. But as you get out of this year, the comparisons do reset meaningfully. Any areas where it kind of feels like the comparisons could be a point of particular differentiation for you?

Dave Zapico - *AMETEK Inc - CEO*

Yes, if you think about our narrative, our first half of the year was much like our second half of the year. So it has kind of flattened out. So there aren't big comparison benefits that we will see going into next year. Now certainly we won't see the oil and gas headwinds. We don't expect to see headwinds in the metals business -- so those will be better.

But it's not like we're entering next year with a bunch of easy comps. The business has flattened out. We are glad it has flattened out. We've got our hands around it, and we are focused on our budget. And the profit improvement that we're going to get in 2017 is going to come from -- what we learned at those budget meetings, it's going to come from our Operational Excellence activities, and it's going to come from M&A.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Got it, that's helpful, thank you.

Dave Zapico - *AMETEK Inc - CEO*

Great, Chris.

Operator

Nigel Coe, Morgan Stanley.

Nigel Coe - *Morgan Stanley - Analyst*

Thanks. Good morning, gents.

Dave Zapico - *AMETEK Inc - CEO*

Good morning, Nigel.

Nigel Coe - *Morgan Stanley - Analyst*

So on the time of the prior placements, it sounds like it's more driven by the Fed's -- like if the Fed goes in December, and therefore, the revolver rate goes up. Is that right? So is it more an indication of your confidence in deploying that capital?

Dave Zapico - *AMETEK Inc - CEO*

Yes, it wasn't -- that wasn't a primary driver. That may happen, but as Bill said, it was a no-brainer. We had revolver debt at short-term rates that we could term out until 11.5 years, and have a very small interest rate change. And that was the primary reason, but we do have confidence that we're going to be able to deploy the capital.

We are well-positioned, I think, in our acquisition world right now. It remains the primary use of our cash flow. It's a core competency and key driver of long-term value. We have disciplined processes around our sourcing, around our diligence, around our integration.

We told you the we have added capacity and made some changes in sourcing new deals. And we expanded our pipeline to slightly larger businesses, while leaving our bread-and-butter deals in the $50 million to $250 million range. Acquisition environment has been pretty tough. We're getting deals done. We got five deals done this year. Deployed $390 million in capital. And the year is not over.

Our pipeline is very good. It appears to have ticked up a bit. And the private placement feeds right into that, because we have about $1.5 billion in cash and unused space on our revolver. So we are feeling really good about being able to deploy the capital, and we're feeling really good about the opportunities also.

Nigel Coe - *Morgan Stanley - Analyst*

Oh, sure. I mean, long-term debt of 1.7% is a no-brainer. But we are seeing more large deals getting done (multiple speakers)

Dave Zapico - *AMETEK Inc - CEO*

Actually, Nigel, it was 1.82%. 1.7% is what our revolver debt is now. We termed it out at 1.82%.

Nigel Coe - *Morgan Stanley - Analyst*

Okay, thanks for the clarification. But we are seeing larger deals get announced in the public market. So I'm wondering if the texture of your M&A backlog is changing, and whether it's seeing a mix towards more large opportunities?

Dave Zapico - *AMETEK Inc - CEO*

Yes, we expanded our pipeline of opportunities to include businesses in the revenue of $500 million. So certainly those deals are working its way through the pipeline. And in terms of mix, there is a larger mix of bigger businesses. But that doesn't change the fundamental bread-and-butter of the business, the $50 million to $100 million, to $200 million deals.

And I think the backlog that we are seeing right now is a healthy mix of the $50 million to $100 million, $200 million deals, and a couple of the bigger deals we're looking at. So we're very active right now, and we don't have anything for sure, definitely. But we're spending a lot of time and effort evaluating these opportunities, and we have the balance sheet to execute on them.

Nigel Coe - *Morgan Stanley - Analyst*

No question. And then on -- a quick one on pricing. Any change in the price environments by business?

Dave Zapico - *AMETEK Inc - CEO*

No, it's about the same. We got about 1.2% of price during the quarter. Largely, it's playing out the same as the prior quarters, where the oil and gas market, the metals market, are where the pricing is most difficult. But overall, we're getting positive price.

Nigel Coe - *Morgan Stanley - Analyst*

Right. Thanks a lot.

Dave Zapico - *AMETEK Inc - CEO*

Thanks, Nigel.

Operator

Robert McCarthy, Stifel.

Robert McCarthy - *Stifel Nicolaus - Analyst*

Good morning, everyone. Well, I guess we didn't have to cut for 2016, so that's good. And I guess there's not going to be much about 2017, and there's been a lot of questions asked. Just expanding a Nigel's comments around price, could you talk a little bit about the pricing environment this year versus previous years? And what would be your expectation if we did see kind of an uptick in either material inflation or better pricing environment, what it would mean for your margins going forward?

Dave Zapico - *AMETEK Inc - CEO*

Yes, because of our strong niche market positions, I definitely feel that we have pricing power in our business. What you saw this year is a lot of migration to lower-capability products within our portfolio. So instead of buying the high-end of a product that can do just about everything, with all the bells and whistles, the customers migrated to more basic functionality. And that really happened in the last downturn back in 2009 also. So we expect it.

So along with that price effect, we have -- which has been very difficult in the markets that are under duress that we've talked a lot about, like oil and gas and metals. You also have a mix affect, where people are buying down the product line. So those would be the two big factors that I would see.

And I think as the market stabilizes, that we will see a slow migration back up to the high-end of the portfolio. And we expect to get positive price. Our pricing was greater than total inflation in the business by a bit in the quarter. So we've been able to offset our total inflation.

It's not a good pricing environment. If I look back a couple of years, we were getting 2 points of price. So it's definitely down, but we are pricing in excess of inflation. And I think that will improve as the general economic level of macroeconomic trends improve.

Robert McCarthy - *Stifel Nicolaus - Analyst*

Well, I mean, obviously a slow macro environment does create opportunity for perhaps increased focus on global excellence, accretes organic improvement, maybe even some restructuring. How are you thinking about that going into 2017 from a planning perspective, in terms of -- if you were in a slow macro environment, what levers can you really pull here to drive longer-term value in 2018 and beyond?

Dave Zapico - *AMETEK Inc - CEO*

Right. So in 2015, we did quite a lot of restructuring. We had two restructurings, and just really completed them recently. And as we look for our businesses through this budgeting process, we're going to look at all the tools we have -- low-cost production sourcing, lean manufacturing -- all the tools in the AMETEK toolkit.

And I feel comfortable. This year we had $130 million in cost reductions from the restructuring and the cost reductions, and I feel confident we will have another healthy number going into 2017. But I'm going to wait to comment on that, because I have to get through the budgeting process, and we have to look at what each of our businesses plans on doing.

Robert McCarthy - *Stifel Nicolaus - Analyst*

Congratulations on a good quarter.

Dave Zapico - *AMETEK Inc - CEO*

Thank you.

Operator

Andrew Obin, Bank of America.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Good morning.

Dave Zapico - *AMETEK Inc - CEO*

Good morning, Andrew.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Just a question. Given, looking where you're able to do your private placement, seems like the rates are quite attractive. As we're sitting at the bottom for interest rates, does that change your view on how much -- what kind of multiples you can pay out for deals, given just how attractive financing is? Because historically, you guys have been an absolute return Company. And what we see is that the Company is liable to do deals in this environment more of a spread approach. Are you reconsidering that?

Dave Zapico - *AMETEK Inc - CEO*

No, not reconsidering that, Andrew. We're still an absolute return Company. I think the key metric for us is our return on invested capital in year-three. That number has been 10% for quite a long time, and it's still 10%. And that means we have to parse the deals that we're looking at. And we need a strong, viable pipeline, which we have now, to find the deals where we can get the hurdle rates of 10% ROIC in year-three.

So we have not taken a relative approach on pricing. It's still absolute. And the returns and pricing on deals, and the pipeline that we have, is better than it's been in the past. And I feel positive that we have the cash and unused revolver capacity to get some deals done moving forward.

Now we can't predict when deals happen any the quarter, because we have to finish our diligence and we have to get through a lot of things. But we have a lot of activity going on, and our teams are active and working many processes. So I am optimistic that some of that will turn into a positive, and we will be able to deploy some of our cash.

Andrew Obin - *BofA Merrill Lynch - Analyst*

And just a follow-up your markets. Historically, you've describes your portfolios as, you know, the bulk of it was very steady, then part of it was not doing well. Within the part that's doing steady, what parts of the business are you paying attention to going to 2017, with potential inflection points?

Dave Zapico - *AMETEK Inc - CEO*

Yes, Andrew, I'm going to come back to the same comment about working through our budgets. But I will comment that are metrology businesses are doing well, our UPT businesses are doing well. The exposure we have to the medical market is doing well. The commercial airspace market -- our OEM commercial airspace sales are strong, and we don't see an ending to that.

So I would point to those for positives. And a lot of our other markets are flat to down a bit, and they are dealing with the same slow grow-over macro conditions, and the same that all businesses are dealing with.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Well, I tried. Thank you.

Dave Zapico - *AMETEK Inc - CEO*

Thank you, Andrew.

Operator

Tristan Margot, Cowen and Company.

Tristan Margot - *Cowen and Company - Analyst*

Hey, guys, good morning. Thanks for taking questions here. Do you consider yourself to be a more cyclical Company now than if we would have asked maybe before prices made their big decline?

Dave Zapico - *AMETEK Inc - CEO*

You know, I believe that just about all markets cycle in the long run, and we do have cyclical closure in our portfolio. 20% of business is down nearly 30%, and we've talked about that. And when you think about AMETEK, our strategy is to focus on a broad, diverse set of niche markets, and to look to grow and expand in these niche markets, both organically and through M&A. So we don't want to become over-exposed in any one single market. In fact, we have the same philosophy of any one single customer or any single technology, so we will look to continue that balance.

We don't have exposure to some of the markets which have been growing recently, like the construction market, nonresidential construction or residential construction. We don't have a big exposure to consumer market. We have a limited exposure to the automotive market. All these markets are cyclical as well, but they are doing well right now and will cycle down at some point in the future.

So the way I look at it, we weathered the worst of the cyclical market downturns in oil and gas and metals. Our cost structure is leaned out. Our businesses remain well-positioned in their niches. We have excellent niche positions. So we are very optimistic we're going to see sizable profit improvement when the market returns.

Tristan Margot - *Cowen and Company - Analyst*

Great, thanks. And then I think you mentioned your thermocouples and using exhaust gases, in your prepared remarks. And I was wondering if you could use that ceramic protection in other application? I don't know, maybe in five years, in refineries or any such applications?

Dave Zapico - *AMETEK Inc - CEO*

Yes, it's possible to use the material in other applications, certainly. The right spot is in exhaust gas thermocouples though, because they are right in the high-temperature exhaust gases, and if you have a thermocouple that can -- your multiple used on every aircraft engine. And if you can get your thermocouple to last a bit longer and it allows the airlines to fly the planes a bit longer, that adds value. And that's the application that we're focused on right now, and we're very optimistic about it.

Tristan Margot - *Cowen and Company - Analyst*

Absolutely. Thank you so much.

Dave Zapico - *AMETEK Inc - CEO*

Thank you.

Operator

Christopher Glynn, Oppenheimer.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Thanks. Sorry to get another bite at the apple here. The mix was a big margin headwind this year, presumably a lack of mix next year. So relative to the organic headwinds this year -- and that's assuming more neutral next year -- what does that mean to lose that mix headwind? How much did that hurt you this year, do you think?

Dave Zapico - *AMETEK Inc - CEO*

Well, I think the mix has been a substantial issue, one of the components of our margin deadline. The biggest issue has been the drop in organic growth rate -- so let's be clear. Then there's a mix effect also. And we didn't get the pricing that we like this year. So all that will go into the mix of figuring out how next year looks. But it really depends on the overall global economic environment. And I can't predict an improvement in mix at this point, but I understand your point. You would think it could get better. But I'm really not saying that at this point until I have gone through the budgets with our folks.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Okay, thanks.

Dave Zapico - *AMETEK Inc - CEO*

Yes.

Operator

Scott Graham, BMO Capital Markets.

Scott Graham - *Jefferies & Company - Analyst*

Hi. Just a quick one for me also, although the answer is probably longer than the question. Dave, as you are going through the budget process for 2017, obviously you're going to tend very carefully to the organic situation. Which, it does not look like your organic sales have declined more than your end markets have, particularly in the two businesses that have been problematic. But I think historically, the view has been that, because of the types of businesses that you're in, that they would not decline as much as the end market. That does not seem to be the case.

So really two questions stem from that. Number one, what is the plan for those businesses to sort of make them out-performance in their market? And secondly, as you approach organic in the other businesses, is there more of a portfolio change that might be needed more toward the faster growing businesses end-markets that you've purchased in recent years, and maybe away from some of the more basic industrial ones that you kind of took with you from last decade?

Dave Zapico - *AMETEK Inc - CEO*

Right. There's a lot of questions there, Scott. We will start with the last question first. You mentioned before, our strategy is to plan a broad set of diverse niche markets. And we look to grow and expand these niches. And really the diversification is a key point. We don't want to get over-exposed in any one single market.

And even though we've had tremendous headwinds in oil and gas and metal markets, we're still very profitable Company -- some of the best margins in the industrial space. So the diversity is serving us well there. When we think about the parts of our portfolio that we are doing well in -- and I mentioned our UPT business, I mentioned the medical space, I mentioned commercial OEM aerospace -- those are in the acquisition queue with all the other businesses. So we'd like to acquire more businesses in those areas, for sure.

When you answer the first part of your answer, saying, I'm actually pleased with the performance of our businesses in the cyclical markets, the oil and gas and metals business. We have leaned out the cost structures. Those are excellent businesses, with excellent positions. And I'm not sure how the organic growth is going to play out, but I can tell you, when it comes back, we're going to make a lot of money. Because those costs structures are leaned out.

And regarding the organic growth of the Company, I mentioned last quarter that we want to focus on the organic growth, and making sure we're getting our fair share of the business. And really focus on the front end of the business, and get as good in our sales and marketing functions as we are in our operational functions. So we need our customer-facing capabilities to equal our strong, operational capabilities. And we are doing that by looking at best practices and tools around our Company, and doing the same thing we did in the operations of applying them to our entire business.

So we're focusing on key initiatives in that area. And that's largely driven from the fact that, the next five years, we might not be able to -- you know, if you think back, from 2005 to 2015, AMETEK grew 3% compounded annual growth rate in organic growth. We grew 8% in M&A. So 11% top line, and we've got 16% compounded annual growth and EPS to the bottom line.

If we wanted to continue that over the next few years, the next five years, which we clearly do, we're just going to take some efforts to work on organic growth across the Company, to make sure that we can outperform in that area. We're not talking a meaningful change in it, not a needle-mover long term. And certainly not any benefit in 2017. But in 2018, I hope we will see some benefits of some slightly better organic growth.

Scott Graham - *Jefferies & Company - Analyst*

Thanks a lot, Dave.

Dave Zapico - *AMETEK Inc - CEO*

Okay.

Operator

Thank you. And no further questions at this time.

Kevin Coleman - *AMETEK Inc - VP of IR*

Okay, great. Thanks, everyone, for joining our call today. And as a reminder, a replay of the call may be accessed on our website at Ametek.com and at StreetEvents.com. Thanks, and have a great day.

Operator

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