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AME - Q3 2017 Ametek Inc Earnings Call

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OVERVIEW:

Co. reported 3Q17 sales of $1.08b, operating income of $232.8m and diluted EPS of $0.66. Expects 2017 overall sales to increase low-double digits on a percentage basis vs. 2016 and diluted EPS to be $2.57-2.58. Expects 4Q17 overall sales to be up low-double digits on percentage basis and diluted EPS to be $0.66-0.67.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Third Quarter 2017 AMETEK Inc. Earnings Conference Call. (Operator Instructions)

I would now like to turn the call over to Kevin Coleman, Vice President, Investor Relations.

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

Thank you, Andrew. Good morning, and thank you for joining us for AMETEK's Third Quarter Earnings Conference Call. With me this morning are Dave Zapico, Chairman and 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 on our website in the Investors section of ametek.com.

This call is also being webcast and can be accessed on our website. The webcast will be archived and made available on our site later today.

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'll also refer you to the Investors section of ametek.com for reconciliation of any non-GAAP financial measures used during this conference call. Please note that any references on this call to full year 2016 financial results will be on an adjusted basis, excluding the fourth quarter of 2016 adjustments.

We'll begin today's call with prepared remarks by Dave and Bill, and then open it up for your questions. I'll now turn the call over to Dave.

David A. Zapico *- AMETEK, Inc. - Chairman & CEO*

Thank you, Kevin, and good morning, everyone. We are very pleased with our performance in the third quarter. The AMETEK business model continues to deliver exceptional results with another outstanding high-quality order. We generated a record level of sales with both strong organic sales growth and solid contributions from our recent acquisitions. We delivered excellent operating performance, which drove a record level of diluted earnings per share. And we generated significant level of operating cash flow with impressive free cash flow conversion, which speaks of the high-quality nature of AMETEK's performance. As a result, we are again raising our full year 2017 guidance across all key metrics.

Now on to the financial and business highlights for the quarter. AMETEK sales in third quarter were a record $1.08 billion, up 15% compared to the third quarter of 2016. Organic sales were up 7%. Acquisitions added 7%, and foreign currency was a 1-point benefit. We are very encouraged about the continued strong level of organic sales growth. It remains broad-based and reflects the strength of our underlying niche businesses.

In addition to the strong sales growth, we continued to see excellent growth in orders. Overall orders were up 16% in the quarter, while organic orders were up 9%. This level of organic growth over a record backlog had nearly $1.4 billion.

Operating income in the quarter was $232.8 million, up 16% from the same quarter of 2016. Operating income margins were 21.5%, up 20 basis points compared to the third quarter of last year. Excluding the dilutive impact on margins of recent acquisitions, operating income margins in the quarter were 22%, up 70 basis points versus the same period in 2016. Third quarter diluted earnings per share were a record $0.66, an 18% increase compared to last year's third quarter of $0.56.

Our business has continued to operate extremely efficiently, leading to strong cash flow generation. Operating cash flow in the quarter was excellent at $239 million, up 41% over the prior year.

Now turning to the individual operating groups. First, the Electronic Instruments Group. EIG sales in the third quarter were a record $671.6 million, up 16% versus the third quarter of 2016. Organic sales were up 5% with the acquisition of Rauland and MOCON contributing 11% increase in sales. Foreign currency was a small tailwind in the quarter. EIG's operating income in the third quarter increased to $164.4 million, up 15% over the prior year. And operating income margins were strong at 24.5%. Excluding the dilutive impact of acquisitions on margins, EIG margins were 25.6%, up 100 basis points over the prior year.

The Electromechanical Group had a great quarter with broad-based sales growth and excellent operating performance. EMG third quarter sales were $413.2 million, up 13% year-over-year. Organic sales were very strong, up 11% with the acquisition of Laserage contributing 2 points and foreign currency was a 1-point benefit. EMG's third quarter operating income was $84.1 million, an increase of 18% versus the third quarter of 2016. Operating margins were excellent at 20.3%, up 80 basis points compared to the same period last year.

In summary, the growth and performance across all of AMETEK, both in the third quarter and over the first 9 months of the year, has been excellent with double-digit growth in sales and earnings for the first 9 months of 2017.

Now before I discuss our updated outlook for the year, let me touch on some exciting recent events that highlight some of the success of our growth strategies.

First, we're very pleased with the performance and integration of our recent acquisitions. With the acquisitions of Rauland and MOCON, thus far, in 2017, we have deployed approximately $520 million in capital and acquired approximately $225 million in sales.

Related to these 2 acquisitions, MOCON, a leading provider of laboratory and field gas analysis instrumentation, recently launched a new system to measure the water vapor transition rate of ultrahigh barrier materials. This new product will help MOCON expand it to several new high-growth market adjacencies. The AQUATRAN Model 3 will help push the performance of highly engineered materials, such as flexible films and organic LED displays used in high-end televisions and electronics and photovoltaics for solar panels, which can be affected by moisture damage. The AQUATRAN system measures each molecule of water that passes through the sensor, providing highly sensitive, accurate and repeatable results.

Also during the third quarter, Rauland, a leader in the design and delivery of critical communications solutions for hospitals and nursing care facilities, launched an exciting new product, the Responder 5000. This new solution was developed to assist nursing care facilities in providing the residents with a high quality of care by providing economic and effective workflow and communications solutions. As a result, the Responder 5000 can help nursing care facilities ensure compliance with Medicare value-based purchasing programs leading to higher levels of reimbursement. The solution has also been customized for use in hospitals internationally with efficient workflow and communications solutions for those markets.

We are very pleased with the performance of these recent acquisitions and are very excited with the growth potential, given their attractive stream of new product offerings and their global and new market expansion opportunities, 2 pillars of AMETEK's Four Growth Strategies.

In addition to these new products from Rauland and MOCON, all our businesses continue to develop differentiated products and solutions to solve our customers' most challenging problems. The success of this work can be seen through our organic sales and orders growth and also on our vitality index, which measures the share of sales coming from new products and solutions introduced within the last 3 years.

In the quarter, our vitality index was very strong at 24%, reflecting excellent engineering and new product development capability, combined with our commitment to investing appropriately in innovation. In 2017, we expect to increase our investment in RD&E to approximately $220 million, which is roughly 5% of sales and up 10% over 2016.

Along with these new acquisitions and new products, our businesses continue to strengthen through our operational excellence initiatives. As we have highlighted throughout the year, we're rolling out several very exciting operational excellence initiatives focused on enhancing the organic growth opportunity across our businesses. Our teams are engaged, and we are excited with the early results we have seen from these efforts.

We also continue to drive impressive results in productivity improvements and cost reductions, as we continue to expect approximately $100 million in total operational excellence savings for all of 2017. Along with these savings, we continue to deliver excellent working capital management, lean to outstanding cash flow generation, which Bill will discuss further in a moment.

One final bit of exciting news I would like to share involves AMETEK's Zygo business and their important contributions to the 2017 Nobel Prize in Physics, which was awarded to 3 scientists for their work in the observation of gravitational waves. Zygo, a supplier of optical metrology instruments, high-precision optical components and complex electro-optical systems, manufactured critical components for the Laser Interferometer Gravitational-wave Observatory. The observatory successfully detected gravitational waves for the first time and, as a result, proved one of Albert Einstein's key elements in his general theory of relativity. This achievement speaks to the high quality and highly technical nature of our businesses and products and the positive impact they are making. We remain focused on strengthening our leadership in differentiated products and in continuing to develop important solutions for our research and science customers throughout the world. I would like to congratulate Zygo for their contributions to this important project.

With that, let me finish with our updated outlook for the year. For all of 2017, we now expect overall sales to increase by low double digits on a percentage basis compared to 2016. Organic sales are now expected to increase mid-single digits on a percentage basis over the prior year. Once again, we have increased our earnings guidance range for 2017. We now expect earnings to be $2.57 to $2.58 per diluted share, up 12% over 2016's adjusted diluted earnings per share. This is an increase from our prior guidance range of $2.46 to $2.52. For the fourth quarter of 2017, we are anticipating overall sales to be up low double digits on a percentage basis with organic sales up mid-single digits. Fourth quarter diluted earnings per share are expected to be $0.66 to $0.67, an increase of 14% to 16% compared to the fourth quarter of 2016 adjusted earnings.

To summarize, AMETEK delivered outstanding performance in the third quarter, and we are well positioned for a strong finish to 2017. Our world-class teams are operating their businesses very well, which is producing high-quality earnings growth and providing solid foundation for future success through our Four Growth Strategies.

I will now turn it over to Bill Burke, who will cover some of the financial detail for the quarter and the year. Then we'll be glad to take your questions. Bill?

William Joseph Burke - *AMETEK, Inc. - CFO & Executive VP*

Thank you, Dave. As Dave mentioned, our businesses continue to perform very well, generating record results during the third quarter. Let me provide some additional financial highlights.

In the third quarter, core selling expenses were up in line with core sales growth. General and administrative expenses in the third quarter were up $2.7 million over the prior year due largely to higher compensation expense.

The effective tax rate for the third quarter was 24.9%, in line with last year's third quarter rate of 25%. For 2017, we now expect our tax rate to be between 26% and 26.5%. As we've stated in the past, 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 17.9% of sales in the third quarter, down from 20.8% in the same period of 2016.

Capital expenditures were $18 million for the quarter and $46 million through the first 9 months of 2017. We expect full year capital expenditures to be approximately $80 million.

Depreciation and amortization for the quarter was $45 million. For the full year, we expect depreciation and amortization to be approximately $180 million.

Our businesses continue to generate excellent cash flow. Third quarter operating cash flow was $239 million, a 41% increase compared to the third quarter of 2016. Free cash flow in the quarter was $221 million, an outstanding 144% of net income. For the full year, excluding that $50 million pension contribution we made in the first quarter, we expect free cash flow to be approximately 125% of net income. Our primary use of the strong cash generation is to support strategic acquisitions. As Dave mentioned, we've been very active on this front in 2017, deploying approximately $520 million on the acquisitions of Rauland and MOCON.

Total debt at September 30 was $2.43 billion, up from $2.34 billion at the end of 2016. Offsetting this debt is cash and cash equivalents of $736 million, resulting in a net-debt-to-capital ratio at September 30 of 31%. At quarter end, we had approximately $1.8 billion of cash and existing credit facilities to support our growth initiatives.

To summarize, the performance from our businesses during the quarter was outstanding and provided high quality of earnings. We look forward to closing out a strong year and remain well positioned to support our growth initiatives with our strong balance sheet and excellent cash flow.

Kevin?

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

Great. Thank you, Bill. Andrew, you like to open the line for questions please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Andrew Obin with Bank of America Merrill Lynch.

Andrew Burris Obin - *BofA Merrill Lynch, Research Division - MD*

Now I will ask a question. If I look at your operating leverage back in sort of 2012, 2013, 2014 period, it does seem was a tad higher versus what we're getting right now. Can you just talk about specific challenges of coming out this prolonged downturn and just how much cost you need to add and whether we can get back to the old operating leverage or this is the kind of level we should be thinking as a new normal?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Sure, Andrew. We think we had a great quarter margin-wise. We were 21.5%, up 20 basis points. But excluding acquisitions, as I said in the prepared remarks, they were actually 22%, up 70 basis points. And if you go to the group lines, the EIG and EMG, ex acquisitions, we were actually up 100 basis points in this group. And we saw incrementals. Core incrementals in Q3 were up 39% on the incremental volume. So we're very pleased with the results. And we believe it's a good thing for our shareholders when AMETEK acquires low-margin businesses. And what you're seeing is the Rauland and MOCON, when we acquired them, they were low to mid-teens EBITDA businesses. And AMETEK is, obviously, much more profitable. So we improved the margins of those businesses substantially. And they may be dilutive to margins for the short term, but ends up driving tremendous value creation in the long run and excellent returns on capital. So we're very pleased with the performance of the strategy. And we think it's endorsed with what we're trying to do with the business.

Andrew Burris Obin - *BofA Merrill Lynch, Research Division - MD*

Now 39% and that interests me that -- another question. Can you just talk about, Dave, since you've taken over, what are the changes that you're implementing? We're sort of hearing about sort of a more structured approach to internal business systems. What can you share about what's happening inside AMETEK culture-wise?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. Andrew, I've been with the company for 27 years and I was part of the culture of the past and part of the culture going forward. And really, the culture hasn't changed. I mean, the 2 areas that we've talked about, we've definitely put a larger emphasis on our organic growth. And we have a structured approach at that and we made it part of our operational excellence program. And we're really getting traction with that organic growth and the tools that we're adding to our toolkit to help our businesses understand the opportunity. And then the second issue is related to the size and scale of the business. We want to double the earnings of the company over the next 5 years, so we increased our acquisition pipeline of businesses a little bit larger, about $200 million to $400 million of revenue. Prior to that time, they weren't in the pipeline of deal. So they're working through the deal pipeline and we're looking at those bigger deals. And we think we can add the same kind of values to them. But it's the same company. The strategy is flexible enough to tweak it when it's needed, but we feel really confident we're on the right track and headed in the right direction for the next 5 years.

Operator

And our next question comes from the line of Scott Graham with BMO Capital Markets.

Robert Scott Graham - *BMO Capital Markets Equity Research - Analyst*

I was wondering if you wouldn't go through your typical buy business -- yes, but even if I may, before that, could you talk about the orders as the quarter progressed? And obviously, I'm not talking about dollars because of seasonality, but on a year-over-year percentage change basis because your second half of last year started to show some more stability in orders. And just kind of wondering what that looked like as each month passed. And now with October done, if you could maybe comment there as well.

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. Our orders for the quarter organically were up 9%, so we had a very strong quarter in orders. And it was broad-based across end markets and geographies and it followed a typical pattern. So we started the quarter a little bit lower and we finished really strongly. So the orders strengthened through the quarter. And if that answers that question, I'll get into the subsegments across -- around the subsegments of AMETEK. I'll start with our overall Aerospace business. Sales for overall Aerospace were up low single digits in the quarter. Similar to last year, we saw strong growth across -- similar last quarter, we saw strong growth across our military business. Our military business has really picked up. We also saw solid growth across our business, the regional jet business due to a ramp-up in shipments and support of new program wins. And for all of 2017, we continue to expect our Aerospace business to be up low to mid-single digits with growth expected across each of our market segments. In addition to solid growth this year, the Aerospace business is a long-term business and you have to win new programs. And our Aerospace teams continue to have excellent success in delivering new long-term program wins across a wide range of platforms. Year-to-date, our teams have already secured over $300 million in LIFO program awards across a range of commercial business jet and military platforms. Next, I'll talk about Process. Our Process business has had an excellent third quarter with overall sales up 20%, driven by contributions from the acquisitions of Rauland and MOCON and by strong mid-single-digit organic growth. The organic sales growth was broad-based across our Process businesses. Now we saw excellent growth across our Ultra Precision Technologies, our UPT business, especially in our Zygo, in our TMC and business units. And given the quarter's solid performance, we now expect organic sales for the Process businesses to be up mid-single digits for the year, so we've increased that a bit. Our Power & Industrial business performed very well in the third quarter with solid mid-single-digit organic sales growth. We saw solid growth from each Power & Industrial segment. Particular strength was across our power test and measurement segment. And we continue to expect organic sales for Power & Industrial to be up low to mid-single digits for the full year. Our differentiated EMG business -- businesses continued to perform very well with another quarter of excellent growth, as end demand remains solid across our key markets. In the third quarter, organic sales for our differentiated EMG businesses were up low double digits, with particularly strong growth in our EMIP and Precision Motion Control businesses. Within our Precision Motion Control businesses, we're continuing to see very strong growth within our Dunkermotoren business, as it is benefiting from strong conditions across its key automation markets. So for all of 2017, we now expect organic sales for all differentiated EMG to be at mid- to high single digits versus 2016. And finally, for Floorcare & Specialty Motors, our smallest segment, organic sales in our Floorcare & Specialty Motors business were up low single digits in the third quarter, as this business continues to see solid demand across its key elements and process key markets and key customers. And for 2017, we continue to expect organic sales for this business to be up mid-single digits.

Operator

And our next question comes from the line of Brett Linzey with Vertical Research.

Brett Logan Linzey - *Vertical Research Partners, LLC - VP*

Just wanted to come back to the growth initiatives. Obviously, a lot of traction there on the channel development and some of the measures you're taking internally, I guess, if you're to look at the order rate of 9% in the quarter, are you able to identify or unbundle that rate between what's being driven by the market and what share gain in some of the opportunities that you think you're winning based on some of these initiatives?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. We are definitely seeing broad-based improvement across our end markets. And we're also seeing improved geographical strength throughout the world. But with 7% organic growth, we're clearly winning share also, both in Q3 and as you see in the first 9 months of the year. And we're certainly seeing tangible success from some of the organic growth initiatives that you mentioned. And we can also continue to see great success from our new product development efforts driving market share gains. But it's very difficult to dissect those in our niche businesses and -- so it's -- we're definitely growing share. And if I pointed to some businesses where I saw excellent performance in -- is our PMC business is -- the automation market is about 10% of sales for AMETEK. And participation in this market is a result of some acquisitions and -- that we based around our core motor technology and has resulted in the acquisitions of Dunkermotoren and Haydon Kerk. And really, those businesses working in unison have perfected the art of delivering custom automation subassemblies to customers. And they're seeing tremendous growth and growing share in a good market. We're also growing share on our Ultra Precision Technologies business. But in general, across the board, we're motivated, we're winning share and we're also benefiting from improvements in end markets and improvements in geographies. And it's very difficult to break those out.

Brett Logan Linzey - *Vertical Research Partners, LLC - VP*

Understood. And then just back to EIG operating margins. Obviously, some dilutive pressure from the 2 deals in 2017. But I guess, as you normalize or you think about the construct into 2018, what was the headwind this year? How much more runway do you have over the next 12 months to improve the operational performance in those businesses? And I guess, I'm trying to dig it out. What's sort of a good placeholder for EIG margins into 2018 as these integrations kind of run their course?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

I understand the question. As we always do, we'll provide our guidance for 2018 when we release our fourth quarter earnings in late January. And our businesses in both EIG and EMG are going through their detailed budget work. And we'll be meeting with each business this month to review those plans for next year. So I'm really not in a position to comment on our expectations for 2018. But I will say that we've stated externally that we think there's margin expansion opportunities for the company. So -- and the number that we've used, as far as the eye can see, is 30 to 40 basis points. And we get to that number by taking the high contribution margin -- margins of our business of 40-plus-percent, 35% contribution margins and adding to that our pricing power and adding to that our tremendous operating capability. So as we sit here and we look out long term, we'll certainly be expanding margins, but I don't want to comment specifically on a group or a business because we haven't done the work yet.

Brett Logan Linzey - *Vertical Research Partners, LLC - VP*

Okay. And then just one follow-up. You said 39% core incrementals. Presumably, most of the pressure, sort of onetime pressure would be in EIG. Electromechanical incrementals were kind of 27%, so implicitly, much higher in EIG on a core basis. What were they on a core basis if you remove some of the deal noise in EIG?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. It was about over 50% on a core basis. I think it was 57%. So you're right on that.

Operator

And our next question comes from the line of Matt Summerville with Alembic Global Advisors.

Matt J. Summerville - *Alembic Global Advisors - MD & Senior Analyst*

Just a quick one in terms of where you were in the quarter on pricing versus raw material input cost and whether or not you have any sort of concern over inflationary pressures adding them to '18, perhaps, more so than you were heading into '17.

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Sure, Matt. Price -- pricing actually improved in Q3 versus the first half of the year for us. So we achieved 1.3% across our entire portfolio and total inflation was about 1%, and it was very balanced across our portfolio with similar results in all our different businesses. So we are very pleased with that. And as you know, some other industrial companies have not been able to offset inflationary cost with increased pricing. So we were concerned with this trend and made sure all our business leaders were aware of it. And we're very pleased with the results. The results speak to a differentiated -- the differentiated aspect and nature of AMETEK's product portfolio and our leadership position in each markets that we're in. And as I said before, in the prior quarter, what you see generally in 2016, the customers will migrate to -- we have a good-better-best pricing marketing philosophy and -- within the AMETEK portfolio. So often, when times are tough and customers don't have a lot of capital to spend, they'll buy our good products. And as the markets tend to improve, product -- customers will buy a fully featured product that are maybe the best, and we'll see pricing expand with that. So -- and we are pleased to see 1.3 points of price in the quarter. And we feel good for fourth quarter, that kind of performance we'll be able to continue.

Matt J. Summerville - *Alembic Global Advisors - MD & Senior Analyst*

And then just a follow-up on backlog. You've continued -- I believe so, at least, continued to build backlogs throughout the year. What have been the key sort of either business or end market contributors to that build? And do you expect further expansion in Q4?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. Our backlog was a record at $1.4 billion. It was broad-based. I mean, we had positive book-to-bill in EIG and EMG. So -- and as we had said in prior quarters, with some of our longer-cycle businesses, they're not going to necessarily shift in the next quarter or the current quarter. They're going to be out there in the backlog. So that's what you see happening. You see our longer-cycle businesses strengthening.

Operator

And our next question comes from the line of Christopher Glynn with Oppenheimer.

Christopher D. Glynn - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Just wanted to -- you talked about areas we're gaining share. Just wanted to see if you could draw a distinction between gaining share or actually creating market size with some of your applications.

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. I mean, creating markets is something that we're doing with some of our technologies, like our Materials Analysis business, and we're doing adjacency work there and adjacency work on our UPT business. And those adjacency works were often taking core technologies and combining it with other technologies into new markets and creating some markets. Our Atom Probe for our Materials Analysis division will be that kind of business, where there's really no competition because we've got the only person to manufacture Atom Probe. And so we're creating a market there and creating a market could take time, and there's a lot of missionary work done on expenses. So we're doing some missionary work like that with our Creaform business also with our -- in our UPT business with some of the 3D metrology. So that's happening, but what you really see is, in general, good markets and share gains adding to 7% organic growth.

Christopher D. Glynn - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

And just in terms of the M&A pipeline, I think some areas, like metrology and power quality, you've done a fair amount of consolidation already. What platforms are you currently seeing as particularly attractive in terms of the fragmentation out there and rightness for you to step up the consolidation?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Right. Well, we have a dedicated team of about 10 M&A professionals who work closely with our businesses to identify strategic acquisitions. And we have -- each of our business units develops an acquisition strategy. So we have a lot of people working on a lot of things across a broad set of opportunities, so we can identify, find good fits for AMETEK and remain disciplined in our return metrics. So we need a big pipeline. We got a lot of people working on it. And we're searching for deals on a lot of areas.

Operator

And our next question comes from the line of Nigel Coe with Morgan Stanley.

Sawyer C. Rice - *Morgan Stanley, Research Division - Research Associate*

You've actually got Sawyer Rice on here for Nigel. Maybe just, first, a high-level question on EPS reporting. We've seen some news from other companies around the industry on shifting to a cash EPS or an EPS that excludes the amortization. Just want to know if you guys have had any -- if that's something you guys have looked at or any thoughts on that metric there.

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. Being an acquisitive company, we certainly would have a benefit if we excluded the amortization. But we report it -- we're a GAAP company and at this time, we decided not to do that at this point. We've -- talking to our investor base about it, even within the same shops, there's an argument within our investor base if we do it or not, so we're listening to it. And we certainly don't want to put ourselves at a disadvantage, but we report GAAP numbers, and we haven't made a decision do -- to do cash EPS reporting. We will report the amortization. So it's out there and it can be calculated and figured out. But we have no plans to do it at this time as probably the best way to state it.

Sawyer C. Rice - *Morgan Stanley, Research Division - Research Associate*

Great. And then maybe just one more if I could squeeze it in here. On the EMIP backlog, just any color on the visibility you have in that business. And then, again, maybe some color on how we should think about order spacing through 4Q and into 2018 in terms of conversion into sales.

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Sure. Yes. In Q3, our EMIP business showed a continuing positive sequential trend. Sales were strong. Orders were also strong in the quarter, a bit better than the EMG average for organic sales. And for the year, for EMG, we're project -- for EMIP, we're projecting mid- to high single-digit organic growth, in line with the EMG average. So very pleased with what's happening in that business. Very pleased with the sequential growth. And our -- it feels like our customers are back to normal, and we're executing well.

Operator

And our next question comes from the line of Robert McCarthy with Stifel.

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Robert P. McCarthy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Senior Analyst*

I guess dovetailing some of the other questions that have come on about margins, maybe you could just give us a state of play for your end markets around specialty metals and oil and gas and, obviously, as it relates to certain divisions as well. But how has been the incremental margin performance there? Has it been in line because I think the previous expectation, sotto voce, was probably in the 40% to 50% range? Have we been seeing it there? Was it a major incremental driver on your incremental margin strength at EMG? And how do we think about, in the context of these end markets, whether we've already seen the bolus of kind of the rebound? Or was that more on the common fourth quarter and going into 2018?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. I mean, we're continuing to see our orders strong and there's broad-based improvement. So orders were ahead of sales in a lot of our markets and a lot of our regions, so we're bullish about that. And our incremental margins were at 39%. And with the contribution of margin in the business, it's about 40%. So we think we're performing at a very strong level. And with the pricing power added to that, that's how we ended up with EIG and EMG core margins at the group line up 100 basis points. So we're really pleased with the -- when you get under the hood, the margins are doing great. And we look at it, even the financial statements with the acquisitions, are doing great. So we're very pleased with our margin performance and we're very pleased with some of the pricing power we saw in the quarter.

Robert P. McCarthy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Senior Analyst*

I guess, but the spirit of the question is maybe drilling into the specific end markets around oil and gas and specialty metals to see what was the relative of mix in those areas and whether that mix is going to be -- to come. Have we seen it? Kind of what's the timing of that kind of incremental strong mix?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. The one point with metals, there's a dynamic there with metals inflation. So the -- as metals inflation increases, we pass that through to our customers. So when you look at the EMG organic sales rate of 11%, about 1 point of that was from metals inflation. So if you want the incremental or contribution margin, it will be on a lower sales number. So that maybe what you're asking your question about. And in terms of EIG, we're really seeing, in the oil and gas business, the upstream market is coming back very strong. We're seeing high-single-digit growth in the upstream and very low-single-digit growth in the downstream. And we're so differentiated in niches. We didn't really give up much price in the downturn. So we got really strong pricing in oil and gas. And those markets are improving and it's a high contribution margin business. And we're optimistic about the future.

Robert P. McCarthy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Senior Analyst*

Well, it sounds from Brett Linzey's comments -- questioning, obviously, the EIG margins were kind in the high 50s on a core basis. And then EMG was kind in the high 20s. So that speaks to the dynamic you're talking about. So I think that's an important nuance. I think the other thing...

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

To be specific, EIG was 57%. Core incremental and EMG was 33%.

Robert P. McCarthy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Senior Analyst*

Math has never been my strong suit. And then finally, just on size decile, is there -- do you think the strategic imperative here for the company, just given the -- how long it takes to do a deal, the fixed cost and association with expecting deals, getting done deals over the goal line, et cetera, et cetera, that could we see larger deals here given your firepower? How should we think about kind of the odds that your pipeline is maybe more shaped towards something larger?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Well, bigger deals are working in the pipeline. And you may see us announce a bigger deal every couple of years and -- but clearly, the core acquisition, the thing that AMETEK is really good at is buying businesses in that $50 million to $150 million range. And that is the predominant acquisitions that you're going to see from us going forward. Our M&A team is set up to process 4 to 6 deals of these simultaneously, and we're out looking at a lot of things. Our pipeline remains active. Our pipeline is very active. We're busy, and we're excited about the quality and breadth of our pipeline. And you can never predict when something is going to transact in the short term, but we don't feel any need to stretch and do a bigger deal. We think there's plenty of opportunities in typical-size deals. But at the same time, we're starting to look at slightly larger deals that are, by no means, marginal vehicles or anything like that. These are $200 million, $300 million revenue businesses that we think we can add a lot of value. But I would say that the predominant acquisition will be those $100 million deals that we've created a lot of value with going forward.

Operator

And our next question comes from the line of Allison Poliniak with Wells Fargo.

Allison Ann Marie Poliniak-Cusic - *Wells Fargo Securities, LLC, Research Division - Director & Senior Equity Analyst*

Dave, can you talk about R&D? 5% of sales today. Any changes the way you're [aligning] that R&D? Obviously, there's some more technical aspects to your portfolio. And I guess, is that an appropriate amount? Or should we be increasing it going forward? Any thoughts there?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. I think the 5% is appropriate and we've been very consistent over a long period of time. And the R&D was increased to about 10% this year, so healthy increase. And we think we're getting a great return on that. And as you know, the way that we manage that, our individual business units put together R&D plan. Those individual businesses will present their plans during their budgets and during their strat plans, and we'll critique them, but they're driving or they're spending their in R&D. Certainly, with the higher technology nature and with a larger size of EIG, we spend a bit more on EIG than EMG. But we've been a consistent spender over the long term and we're really happy with what's happening. We have up-to-date fresh products and we're winning shares, so we're very pleased with our R&D efforts. And I can just also add that over the past few years, we've added a tremendous capability in India. We've about 110 engineers over there. They're augmenting our product development capability. And in our niche markets, we have some of the rock stars of the industry in terms of our engineering capability with people that really know the products and the applications and take the technology forward. So we have a great niche business of great technologies, and we think we're spending appropriately.

Allison Ann Marie Poliniak-Cusic - *Wells Fargo Securities, LLC, Research Division - Director & Senior Equity Analyst*

Great. And then just going back to the M&A pipeline. You talked about it being active. As the industrial economy recovers, has there been any, I guess, pushback, changes to multiples? Any different color that you've been seeing there?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. Sure. I mean, the current environment, it's very similar to what we've been experiencing recently, and pricing is elevated. There's no doubt about that. There's plenty of cash chasing deals. Despite this, we've been successful in deploying our free cash flow on acquisitions that will enhance the value of the company. So we are really parsing a very robust pipeline to find the deals where we can remain disciplined on our return metrics.

And we'll select the deals and we'll do the deals that -- and we're focused on return on capital when we do a deal. So we have $1.8 billion of firepower, and I'm really optimistic with what I see in the pipeline.

Operator

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

Jeffrey Jacob Reive - *RBC Capital Markets, LLC, Research Division - Associate*

This is Jeff Reive on for Deane Dray. And maybe to continue with some of the M&A multiple, so given the multiples are fairly high, are you guys making any considerations for portfolio-pruning actions?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

We did -- or we ended our strategic plan -- planning process in the first half of the year, and we're very comfortable with our portfolio at this time. Our strategy is to focus on a broad, diverse set of niche markets. And we look to grow organically and through acquisitions in these niches. We don't want to become overexposed in any single market, any single customer. And we weathered a bit of a downturn over the past couple of years, and all of our businesses have a bright future looking out the next 2 or 3 years. And so right now, that's our position. And certainly, we look at it, at least, annually and those decisions can change. But right now, we're very comfortable with our entire portfolio.

Jeffrey Jacob Reive - *RBC Capital Markets, LLC, Research Division - Associate*

Great. And just one more. I know you're not giving any 2018 guidance, but could you provide some qualitative, maybe broader macro commentary for your setup into 2018?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Sure. I mean, the -- we feel good about our markets. We're, obviously, very happy with the performance we have. Our execution is excellent, and we expect our execution to continue. But I want to hear from our teams before we put any numbers out there for 2018.

Operator

And your next question comes from the line of Brett Kearney with Gabelli and Company.

Brett Kearney

I was just wondering if you can talk at all about the recent additions and, I guess, promotions you've had within the executive team and any additional hires kind of contemplated there in order to achieve your growth objectives.

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

There's a couple of recent promotions. We're in the finance world, so I'll let Bill talk about that.

William Joseph Burke - *AMETEK, Inc. - CFO & Executive VP*

Yes. We were -- have added a Treasurer to AMETEK. His name is Dalip Puri. He has come -- has been Treasurer with several other large companies prior to joining AMETEK. So we're happy to have him come along and augment the team there. He's got a really strong background in treasury. And we're pleased to include him as part of the team. And then the second addition was Brian Nash, who we promoted from our power systems and instruments division as our VP of Operational Finance. And that's -- as we grow as a company, we want to make sure that we've got an adequate group of folks here in corporate to support our businesses and, really, to help as we get larger to drive the AMETEK culture through the acquisitions and make sure that we maintain the strong disciplines that we've had over a long number of years. And promoting one of our best divisional folk up into a corporate role is great, and then we'll backfill from there. So very pleased with the strengthening of the corporate finance team over the course of the last 6 to 8 months.

Operator

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

Joseph Craig Giordano - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

I know we're not going to get 2018 guidance here, but just want to kind of put the EMIP business into the appropriate context with metal prices up and aircraft build rates expected to ramp next year. So can you kind of maybe frame out a scenario as to how that business enters the year? I mean, could we be looking kind of like a material movement in that segment of EMIP next year, particularly some of the specialty metal stuff and the connectors?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. I see -- with EMIP, we're seeing -- in 2016, there was a financial problem in the metals market. And we were really well positioned with niche products. And we told you at that time that the end markets were good, but the metals market, in between us and our end customers, were poor. So what you really saw was that market in some distress. And what you really see now with the year, mid- to high single-digit growth in our EMIP business is really a reflection of that improvement. So we think we're at a level now that we're performing very well at, and we're very pleased with EMIP.

Joseph Craig Giordano - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

And probably, wouldn't be anything to think that, that can even accelerate further as that build rates go higher. Is that fair?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

I'm not going to comment on 2018, Joe.

Joseph Craig Giordano - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

That's fair. Fair enough. Maybe you can comment a little bit on how the front end of your business looks today versus maybe how it looked a year or 2 ago. I mean, I know you guys with an engineering background had a bit more focus on driving the front end and the sales channel more recently. So how does that look today? How do you feel about that now versus maybe when you stepped into the role?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

I feel really good about what's happening on the front end of our business. And we wanted to make our customer-facing capability as really as strong as our operational and engineering capability, and we're using some tools. I talked about growth kaizen in a prior call, where we're getting after ways to improve our distribution channel and our niche markets. We have a focus on digital marketing now to take some of our businesses that are truly world class and bring all of them up to that level. We have a program on sales force effectiveness that involves leadership development and compensation of our sales force. We're focusing on the aftermarket side of our business. We think there's opportunities to grow there. So I'm very pleased with what's happening in the front end of our business and the focus on improving organic growth.

Operator

And our next question comes from the line of Rob Mason with Baird.

Robert W. Mason - *Robert W. Baird & Co. Incorporated, Research Division - Associate*

The prior commentary talked about, or at least referenced, broad-based growth globally, geographically. So just curious if you could drill down into that how the various geographies look. And specifically, I know North America had kind of lagged Asia, Europe through the first half of the year. And specifically maybe give some color on North America and which businesses you're seeing gain some strength there because it -- seemingly, that's the case.

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. That's an excellent point because what we really saw this quarter was tremendous strength in the U.S. The -- our U.S. business was up high single digits and was improving sequential trend from about -- I think it was low single digit, 1% actually last quarter. So we saw tremendous strength in the U.S. and it was broad-based strength. It was the military business. It was our Aerospace business. It was our metals business. It was oil and gas. It was really strong. It was across the board. So we're very pleased to see that. In Europe, we were up mid-single digits, in line with recent trends. That was also broad-based and notable strength. I mentioned our Dunkermotoren business was very strong in Europe. Our Process business was very strong in Europe. And in Asia, we had another great quarter, up high single digits, continuing the growth that we've been seeing. So across the geographies, we're very pleased with what we're seeing.

Robert W. Mason - *Robert W. Baird & Co. Incorporated, Research Division - Associate*

Okay. That's helpful. Just one follow-up. So it has been good to see the outlook ratchet up as we've gone through the year. And I think you made reference to higher compensation as well. Any way to size what that year-over-year delta is going to probably shake out for '17 in compensation or as a margin headwind year-over-year?

David A. Zapico - *AMETEK, Inc. - Chairman & CEO*

Yes. For -- I mean, our G&A in Q3 was up about 20% and it was largely driven by higher compensation expense. So that would be the best way to -- Bill?

William Joseph Burke - *AMETEK, Inc. - CFO & Executive VP*

It's a $10 million kind of number for that.

Robert W. Mason - *Robert W. Baird & Co. Incorporated, Research Division - Associate*

For the full year.

William Joseph Burke - *AMETEK, Inc. - CFO & Executive VP*

For the full year.

Operator

And I'm showing no further questions at this time. So with that, I'd like to turn the call back over to Kevin Coleman for closing remarks.

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

Great. Thank you, Andrew, and thank you, everyone, for joining us today. And as a reminder, a replay of today's call can be accessed in the Investors section of ametek.com. Thank you, and have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a wonderful day.
