

IDEX Corp. (IEX)

Excelling as a Specialist of Specialties

IDEX is a multi-industrial engineered products company that serves niche markets around the world. It supplies specialty pumps, fluid measurement, metering, fluidics systems, and a host of other specialty products for an array of industries. IDEX's wide range of products have applications for industrial, health and science, and fire and safety markets. The common theme among IDEX's 48 businesses is that they play in niche, highly engineered applications, where the cost of failure is high.

IDEX is the global #1 or #2 in each of its niche markets, where the total addressable market is typically under \$2 billion. This niche market strategy gives them the ability to lead on market innovation and pricing while limiting the threat of new entrants, particularly among well-resourced mega-caps.

IDEX's products and systems are highly engineered – meaning the development process is driven by application and process knowledge, tailored to specifications, and requires extensive engineering work, complex sub-assemblies, frequent testing, and many individual parts made by IDEX. This creates upfront involvement with their customers, which allows IDEX to add value through their world-class commercial organization and, ultimately, to create a “partnership” structure with high switching costs.

Another of IDEX's notable competitive advantages is that it competes in mission-critical applications where the cost of failure is high. Examples include pneumatic pumps and gas compressors used in operating rooms; ventilators, and nebulizers for hospitals; flowmeters for aviation fuels; high-purity fluid handling systems for semiconductor production; BAND-IT® clamps used in airbags and in demanding military, space, and aerospace applications; analytical instruments and fluidic systems in life sciences and laboratory markets (IDEX has a leading position in DNA sequencing); and high-precision sealed chemical and pharmaceutical pumps. IDEX's focus on high-demand applications creates high barriers to entry for new competitors, establishes sticky customer relationships, and gives IDEX pricing power and the ability to expand margins over time.

IDEX Operating Model

We have found that companies with differentiated business systems have compounded value at high rates over long periods of time. A business system is the combination of core processes, values, and culture that directs and pulls an organization. As an example, Danaher Corp., another Weitz holding, has credited Danaher Business System (DBS) as their most valuable asset and the core driver of their long-term success.

We believe the “IDEX Operating Model” is a similar asset that differentiates the IDEX organization – particularly through lean continuous improvement and the deployment of 80/20. The concept of 80/20 is derived from the Pareto principle, which states that 80% of outcomes or outputs come from 20% of the causes or inputs. Applied to IDEX's companies – a small subset of customers, products, and end-market applications have an outsized impact on growth, profitability, and returns. The IDEX Operating Model directs the organization's focus and resources to this 20% that has an outsized impact on long-term returns. IDEX has developed a unique culture and data-driven companywide processes to segment their markets. This segmentation drives research and development (R&D), commercial resources, and – importantly – capital allocation. These processes have kept IDEX focused on critical technology and value-added components and away from system integration with its lure of additional revenue.

Lean continuous improvement is the elimination of non-value-added work and the creation of “flow” throughout the organization. The combination of lean with 80/20 creates a corporate culture focused on “over serving” their best customers and markets, while also eliminating non-value-added complexity that consistently resurfaces in a highly engineered model. Over time, the IDEX Operating Model has materially increased the quality of IDEX's businesses, improved organic



NATHAN RITZ, CFA
Research Analyst

Nathan joined Weitz Investments in 2011. Prior to joining the firm, Nathan interned at Moody Aldrich Partners and was a credit analyst at West Gate Bank. Nathan has a bachelor's in finance, economics and mathematics from the University of Nebraska-Lincoln.

growth and growth runway, expanded margins, reduced capital intensity, increased free cash flow generation, and has culminated in a high return on invested capital (ROIC).

World-Class Management Team

IDEX is led by a talented CEO, Andy Silvernail, who had his roots at Danaher. True to IDEX form, Andy has focused on two priorities that he believes can have the largest impact on long-term value creation: 1) building great teams and unlocking the potential of their people and 2) being good stewards of capital. We believe these are two of the most important roles for a CEO.

IDEX operates a highly decentralized organizational structure. Executive management's role is to provide the environment and tools for their business units to thrive. Decision making and financial statement ownership are driven down to the general manager level. This creates an environment where general managers are incentivized to run the business like it is their own. Entrepreneurial potential is unleashed, and focus is directed to the end-customer and users at the front line.

The organization becomes more agile and responsive to market and customer demands. IDEX excels at allowing the voice of the customer to drive their commercial organization, from product development and R&D, to aligning their engineering team around solving customer problems, to expanding their product portfolio into value-added adjacencies. IDEX's decentralized organizational structure along with extensive training, talent development, and recruitment programs have led to industry-leading employee engagement and retention rates.

IDEX's business model generates strong free cash flow, and management has done a superb job of reallocating capital over time. Acquisitions have been a core use of capital and IDEX is one of the rare success stories. The IDEX Operating Model has played a key part in this success, but management has also put in place guardrails that have increased their "hit rate" on acquisitions. IDEX is fishing in the right ponds where they are targeting smaller niche markets (\$500mm to \$2B) and sourcing proprietary deals. They are looking to become better, not bigger, which means strategic fit and similar business characteristics, including highly engineered mission-critical applications, products that are a small piece of customers' total spend, high switching costs, pricing power, low capital intensity, and high free cash flow. Finally, management has ROIC hurdles of 12% by year three of ownership and 15% by year five. Management has also opportunistically repurchased their own stock when it has offered the highest return use of capital. They have reduced their share count by 10% over the past five years.

An All-Terrain Vehicle

Despite some impact to the cyclical pieces of the IDEX portfolio, we believe the company is well-positioned to thrive coming out of the COVID-19 economic downturn. IDEX has a diversified set of businesses and end-markets that exhibit resilient pricing and generate strong free cash flow even in contractionary environments. A long-term-oriented management team and decentralized organization give IDEX the agility to respond to market conditions and the ability to continue to invest organically for long-term value creation. Finally, Andy and his team have been opportunistic, adding value through acquisitions and share repurchases in the past. With low debt at just 0.7x net debt-to-EBITDA (earnings before interest, taxes, depreciation and amortization), there is an opportunity for the company to play offense in an environment where few others can.

For years, IDEX has been targeted as an aspirational holding in the Weitz Investment Universe (an ever-evolving list of companies that fit into our investment methodology and are covered by our research team). It is a rare investment opportunity where we can check all the boxes on business quality and moat, management team, corporate culture, and capital allocation. In March, with the market downturn on the back of COVID-19, the final piece of the puzzle – valuation – fell into place. For a company that, in our estimation, can compound free cash flow per share in the low-teens and generate incremental returns on capital nearing 30%, we were able to initiate positions in Partners Value, Hickory, and Balanced funds at 19x trailing free cash flow per share, only a slight premium to the S&P 500 index's 17x. From these levels, we estimate that IDEX is likely to generate a 13-15% internal rate of return over our five-year investment horizon.

IMPORTANT DISCLOSURES

Past performance is not a guarantee of future results. All investments involve risks, including possible loss of principal.

As of 06/30/2020, each of the following portfolio companies constituted a portion of the net assets of Balanced Fund, Hickory Fund, Partners III Opportunity Fund, Partners Value Fund, And Value Fund as follows: Danaher Corp. (DHR) 1.7%, 0.0%, 0.0%, 0.0%, and 4.3%. IDEX Corp. (IEX) 1.1%, 1.6%, 0.0%, 1.5%, and 0.0%.

Holdings are subject to change and may not be representative of the Fund's current or future investments.

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