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AME - Q2 2017 Ametek Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 sales of $1.06b, operating income of $232.4m and diluted EPS of $0.65. Expects 2017 overall sales to be up high-single digits on a percentage basis vs. 2016 and diluted EPS to be $2.46-2.52. Expects 3Q17 overall sales to be up approx. 10% and diluted EPS to be $0.60-0.62.

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PRESENTATION

Operator

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

I would now like to introduce Vice President of Investor Relations, Mr. Kevin Coleman. Please go ahead, sir.

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

Great, thank you, Andrew. Good morning, and thank you joining us for AMETEK's second quarter earnings conference call.

With me this morning are Dave Zapico, Chairman of the Board and Chief Executive Officer; and Bill Burke, Executive Vice President and Chief Financial Officer.

AMETEK's second 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 conference call is also being webcasted 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 a reconciliation of any non-GAAP financial measures used during this call. Also, please note that any references on this call to full year 2016 financial results will be on an adjusted basis, excluding the fourth quarter 2016 adjustments.

We will begin today's call with prepared remarks by Dave and Bill, and then we'll open it up for your questions.

I'll now turn the call over to Dave.

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

Thank you, Kevin, and good morning, everyone.

AMETEK had another excellent quarter. We delivered results and exceeded our expectations and continue to see very solid growth in both sales and orders. This growth is broad-based across our businesses.

Our businesses are executing very well, which is evident in our strong operating performance and cash generation. This strong sales and operating performance is translating into excellent earnings results, with diluted earnings per share in the second quarter up 10% over the prior year. As a result, we have again raised our full year earnings guidance range.

Now on to the financial and business highlights for the quarter. Sales in the second quarter were a record $1.06 billion, up 9% compared to the same quarter in 2016. Organic sales were up 4%, acquisitions added 6% and foreign currency was a 1% headwind in the quarter.

We are very encouraged with the continued strong level of organic growth -- sales growth as it again exceeded our expectations.

We also saw excellent growth on orders, with overall orders up 20% and organic orders up a very strong 12%. This order performance follows a strong order performance we saw in the first quarter and is driving a record level of backlog at over $1.3 billion.

Operating income in the quarter was $232.4 million, up 6% from the second quarter of 2016. Reported operating income margins were 21.8% in the quarter, with core margins at 22.7%, up 30 basis points versus the prior year.

Diluted earnings per share was $0.65, an increase of 10% compared to last year's second quarter of $0.59 per share.

Our strong operating performance continues to translate into excellent cash flow generation. Our operating cash flow in the quarter was excellent, with free cash flow conversion at 123% of net income.

Now turning to the individual operating groups. First, the Electronic Instruments Group. In the quarter, EIG sales were a record $657.7 million, up 10% versus the second quarter of 2016. Organic sales were up 2%, the acquisitions of Rauland, Nu Instruments and HS Foils contributed 9% and foreign currency was a 1% headwind. EIG's operating income for the second quarter was very strong at $165.2 million, up 9% versus the same period in 2016, with operating income margins an excellent 25.1%.

The Electromechanical Group had another great quarter with robust sales and orders growth. Overall sales were up 7% versus the second quarter of 2016. Organic sales were also up 7%, with 1% acquisition growth, offset by a 1% foreign currency headwind. EMG's second quarter operating income was $85.6 million, up 7% over the prior year with operating income margins a very strong 21%.

Overall, our results for the quarter were outstanding. AMETEK is performing very well, and we are poised for a strong second half of the year.

Before I discuss our updated outlook for the year, let me touch on developments in our forward growth strategies. First, acquisitions. We are very pleased with our average on the acquisition front. We completed the acquisition of MOCON on June 22 following shareholder and regulatory approvals. MOCON is the leading provider of laboratory and field gas analysis instrumentation to research labs, production facilities and QC departments in food and beverage, pharmaceutical and industrial applications. We are very excited about this acquisition, and I would like to welcome the MOCON team to AMETEK. With the acquisitions of MOCON and Rauland, 2 very high-quality businesses, AMETEK has deployed approximately $520 million in capital thus far in 2017.

Our M&A and business development teams remain very active in developing our acquisition pipeline. We remain confident in our ability to continue to deploy our free cash flow and value-enhancing acquisitions. And as we have proven, AMETEK has a robust acquisition process in place to integrate and improve acquired businesses.

Next, New Product Development. We continue to design and develop new products and solutions to solve our customers' most complex and challenging problems. We have outstanding engineering talent combined with excellent new product development capability. Our Vitality Index, which measures the portion of total sales coming from new products, was excellent, at 25% of sales in the second quarter. This level of vitality speaks to the quality and success of our new product development efforts.

I wanted to highlight one example of a new product introduced in the second quarter, the Creaform MaxSHOT Next. The MaxSHOT Next is a new optical coordinate measuring system designed for large-scale metrology projects mainly in the Aerospace, Automotive and Transportation industries. With this new product, Creaform has achieved a major industry milestone by developing an intelligent measurement solution that autonomously guides users to the right measurements with 40% more accuracy and unparalleled ease-of-use. This product received the prestigious Red Dot Design Award for design excellence in 2017. Creaform is an excellent example of a business that has generated a significant organic growth and excellent market expansion through the development of new products and solutions around this core 3D metrology.

Across all of our businesses in 2017, we expect to increase our investment in RD&E to approximately $220 million, which is roughly 5% of our sales. This is an increase of approximately 10% over 2016.

We also continue to expand in new markets around the world. International sales in the second quarter made up 51% of our total sales with very strong organic growth in China, India, the Middle East and other parts of Southeast Asia due to the investments we have made to expand our presence in these regions.

In addition to these incremental investments, we have also expanded our operational excellence capabilities with new tools targeted at improving our sales, marketing and channel management processes. One of the new tools are growth kaizens. Growth kaizens are specific continuous improvement projects targeted at expanding our market share in attractive growth market or geography where our business unit may be underpenetrated. About 1 year into our rollout, we are very pleased with the success we are seeing in the -- expect the expansion of this growth kaizen process across more of our businesses to drive continued incremental growth opportunities.

We are also pleased with our efforts to improve overall efficiency and drive operational savings. For all of 2017, we continue to expect approximately $100 million in total operational excellence savings. In addition to this level of savings, our teams continue to drive meaningful improvements in working capital, thus driving improved operating performance and cash flow generation. Bill will provide more specific details on our working capital performance, but I wanted to commend our team for their great work in this area.

Now let me switch to the updated outlook for the year. For all of 2017, we now expect overall sales to increase high single digits on a percentage basis compared to 2016. Organic sales are now expected to be up low to mid-single digits.

We have increased our earnings guidance range for 2017 to $2.46 to $2.52 per diluted share, up 7% to 10% over 2016 adjusted earnings. This is an increase from our prior guidance range of $2.40 to $2.48.

For the third quarter of 2017, we're expecting overall sales to be up approximately 10%, with organic sales up low single digits. We anticipate diluted earnings per share for the third quarter will be in the range of $0.60 to $0.62, up 7% to 11% compared to the third quarter of 2016.

To summarize, the second quarter results were outstanding with high-quality earnings growth driven by sales and superb operating performance. The exceptional work that our world-class teams have put in through the first half of the year has positioned the company for very strong earnings growth in 2017. Through our 4 growth strategies, we are focused on maximizing the company's potential in our improving markets and investing in a future to provide both short- and long-term success.

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

William Joseph Burke - *AMETEK, Inc. - CFO, EVP and Treasurer*

Thank you, Dave. As Dave mentioned, our businesses performed very well in the second quarter, delivering excellent cash flow and operating results that exceeded our expectations. I'll provide some financial highlights.

In the second quarter, core selling expenses were up less than its core sales growth. Our second quarter general and administrative expenses were up $5 million over the second quarter of 2016 due largely to higher compensation expense, including costs associated with the retirement of our Executive Chairman.

The effective tax rate for the second quarter was 26%, down from the second quarter of 2016 rate of 27.5% due to ongoing tax planning initiatives and the benefit from stock-based compensation. For 2017, we now expect our tax rate to be approximately 27%. Please keep in mind that 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 an excellent 17.9% of sales in the quarter, down from 19.8% in last year's second quarter.

Capital expenditures were $14 million for the quarter and $28 million for the year-to-date. For the full year, we expect capital expenditures to be between $75 million and $80 million.

Second quarter depreciation and amortization was $44 million, and we expect full year 2017 depreciation and amortization to be approximately $180 million.

We continued to generate very strong cash flow in the quarter. Operating cash flow was $199 million, up 5% from the second quarter of 2016. Free cash flow was $185 million or 123% of net income.

For the full year, excluding the $50 million pension contribution we made in the first quarter, we expect free cash flow to be approximately 125% of net income.

We have been very active in deploying our free cash flow this year. In the second quarter, we deployed approximately $184 million on the acquisition of MOCON. That brings our cumulative expenditures for acquisitions in 2017 to approximately $520 million.

Total debt at June 30 was $2.4 billion, up from $2.34 billion at the end of 2016. Offsetting this debt is cash and cash equivalents of approximately $515 million, resulting in a net debt-to-capital ratio at June 30 of 34%.

At quarter end, we had approximately $1.5 billion of cash and existing credit facilities to support our growth initiatives.

To summarize, the performance from our businesses was outstanding and provided a high quality of earnings. We remain well positioned to support our growth initiatives with our strong balance sheet and excellent cash flows. Kevin?

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

Great, thank you, Bill. Andrew, we're now ready to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Matt Summerville with Alembic Global.

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

A couple of questions. First, can you talk about the EIG business for a moment? And maybe what drove the organic -- or the deceleration in organic growth in that segment in the second quarter versus what you saw in Q1? And also kind of what the expectation would be going forward.

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

Sure, Matt. Yes, EIG had a 2% organic growth in Q2, but that was really a situation of large job shipping or shifting to the right. The reason that I'm not worried about it because the organic growth of EIG was 8%. So we're very bullish on the second half for the year of EIG, and it really was just a 1-quarter issue and it really wasn't that bad. And, again, with the 8% orders growth organically, it looks good for the second half.

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

Got it. And then with respect to, maybe, the linearity. Maybe can you comment on the linearity you saw in organic orders in the quarter? And whether or not the volatility we've seen in oil prices as of late has resulted in any volatility, I guess, in particular in the EIG business? And then if maybe you can just close the loop on what the issue was in terms of what exactly moved out of Q2 into a later period?

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

Yes. The first point is there is always jobs that move in and out, so there wasn't one specific job. The orders for the quarter were generally increasing. They started April where we thought they would and they increased and they were very strong in June. So typical quarterly pattern, but it ended in a very strong June.

Operator

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

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

So we've heard a lot from the industrial peers around price cost. It's a little bit of a challenge in the quarter. Could you just talk about separately what price was? And any commodity input cost that are giving you some challenges here in Q2 or the back half.

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

Sure, Brett. Our price across the company was a little over a point in Q3, so that's a little over a point positive price, and total inflation across the company was about 1 point. So we were a slight benefit to the P&L. And when we look out for the second half of the year, we expect similar environment. Inflation may pick up a bit but we think we can get some more pricing also. So we don't -- because we're at with our products, very differentiated in most of our businesses, we really don't see inflation moving through the channel yet, and I expect to maintain a positive price-cost ratio throughout the year.

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

Okay. And then you guys have maintained the view for flattish markets for the metal and oil and gas businesses for the year. Any change for the guidance or expectation here? And I guess, how did orders specifically in these 2 businesses trend in Q2?

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

Right, that's a great question. Our EMIP business, as we went into the year, we called that flat. And we mentioned in Q1 that sales were flat but orders were slightly ahead of sales. And we continue to see improved end market conditions, with orders up sharply and organic sales up mid-single digits in the quarter. So if you look at EIG, EMG had organic orders of 17% and the EMIP business, the metals business exceeded that rate. So really, you got a situation where the EMIP orders bounced back sharply. And in terms of oil and gas, it was a similar story. We entered the year -- we were pleased with our first quarter performance of flat sales, and orders were a little bit ahead. Our current forecast now was for oil and gas to be up low single digits. We now expect upstream to be up high single digits and the mid- and downstream business to be flat. So we feel pretty good about both metals and oil and gas. They were the 2 end markets that caused us some headwinds. So those headwinds are no longer there, and we're performing very well, and we're very optimistic for the second half of the year.

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

And then, specific to the metals business, are you able to parse out what was price versus volume in the quarter?

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

I think it was a couple of points of EMIP on -- which was related to metals inflation, if you will. And then, the balance was underlying growth in the business.

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. I was just wondering if we could -- you guys could help us think about the impact of the weaker U.S. dollar here. Just, kind of, what's the embedded FX in the top line guide? And are you guys seeing any changes in the competitive environment globally due to the weaker dollar?

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

Sure, it's a great question. We saw roughly 1 point of FX headwind to sales in Q2, which was similar to what we saw in Q1. With the dollar weakening a bit recently, we expect there to be no real FX impact in Q3 and likely a bit of a tailwind in Q4 if it stays as it is. So for the year, for the full year, we expect a modest FX headwind turning around in Q4. And as we talked about last year when the dollar is strengthening, we're a big exporter from the U.S. We export about $1 billion. And with the currency weakening, with the dollar weakening, it certainly going to improve our competitiveness. So we're encouraged with that.

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

Great, and then maybe if I could just get a follow-up in here on M&A. I wonder what the purchase price accounting impact was for the quarter. And any way to, kind of, help us bridge core versus M&A impact on margins into the back of the -- back half of the year here?

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

Yes. What I can tell you is that at the -- we already talked about the core operating income margins being up 30 bps, 22.7%. And if we look at the EIG and the EMG segments, the group level, the operating income on a core basis was up 50 bps, and for EIG, it was up 60 bps for EMG. So we had really good performance, and we had some below-the-line G&A stuff and that included covering the onetime cost and the acquisition cost that we don't typically carve out. So the underlying business is strong, and what you saw was the reported operating margins of 28% -- 21.8% that included all that acquisition-related work.

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'm going to ask my typical question about laying things out within the divisions. But I would also like to tack on to that, if I may, what was the sort of onetime isolated cost of the Executive Chairman charge? It looks like it was in corporate.

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

Yes. If you look at our G&A costs, we were up about $5 million over last year, and about half of that was from the incentive comp that we talked about in past calls. We really had low incentive payouts in 2016, and now we're obviously performing much better. So about half of that was the incentive comp and about half of it was related to the retirement of our Executive Chairman. And going around the business, I'll start with Aerospace. Our overall Aerospace sales were up low single digits in the quarter. We saw a solid growth across each of our segments, including continued strong growth in our commercial OEM business, and we saw higher military sales in the quarter. We saw excellent order growth in the quarter driven by a number of large military projects that -- well, they were, if you recall, talking about them in 2016, they were sliding to the right. Well, they actually booked in the first half of this year, as well as continuing solid commercial orders. So for all of 2017, we continue to expect our Aerospace business to be up low to mid-single digits, with growth expected to be across all of our -- each of our market segments. Our Process businesses had a solid second quarter with overall sales up mid-teens and organic sales up low single digits. Orders were also strong in the quarter with broad-based strength. Sales for our oil and gas businesses were up low single digits in the quarter, continuing their positive sequential trends. We now expect low single digit growth for oil and gas for all of 2017. As a result of the solid orders, we now expect organic sales for the Process businesses to be up low to mid-single digits for the full year. Organic sales for our Power & Industrial businesses were up low single digits in the quarter, with similar levels of growth across both our Power & Industrial businesses. Given the strong order growth in the first half and improved heavy truck demand, we now expect organic sales for Power & Industrial to be up low to mid-single digits for the full year. Organic sales for our differentiated EMG businesses were up mid-single digits in the quarter, with solid growth across all of our businesses. Our EMIP business continued to see improved end market conditions. I mentioned previously, orders were up sharply and organic sales up mid-single digits in the quarter. And for all of 2017, we now expect organic sales for all of differentiated EMG to be up low to mid-single digits versus 2016. And finally, organic sales in our Floorcare & Specialty Motors business were up high single digits in the second quarter as this business continues to perform very well. For 2017, we continue to expect sales for this business to be up low to mid-single digits organically.

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

Okay, that's very helpful. I appreciate it. If you don't mind my sneaking one more in here...

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

Sure.

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

Your third quarter organic sales guidance, I think you said low single digit?

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

Yes, that's correct. Q3 sales will be up about 10% and we have organic sales up low single digits.

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

And when we compare that to the organic orders of the first half, which were up double digits, can you kind of connect those dots?

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

Right, right. I'll connect the dots. The first point is Q4 will be a bit stronger than Q3, the way that the backlog is playing out. And the orders were very strong as your point, with broad-based improvement across all of our end markets. Many of our orders have multi-quarter or multiyear patterns as customers return to their normal ordering pattern. So as an example of our EMIP business that we talked about, customers placed blanket orders that typically shift -- ship over the course of the year. So we're executing very well. We have a high degree of confidence on our outlook. We do feel good about how the year is playing out, but it's just the fact that the orders that are being placed are more in our mid- and long-cycle businesses like our military business, like our metals, our EMIP business. And those are more multi-quarter, multiyear ordering patterns.

Operator

And our next question comes from the line of Bhupender Bohra with Jefferies.

Bhupender Singh Bohra - *Jefferies LLC, Research Division - Equity Analyst*

So my question is around MOCON. If you can just give us some color on how that acquisition is progressing. Just give us some color on the sales and orders. And how much of, if any, accretion from that acquisition is going to contribute towards the guidance here in 2017?

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

Right, yes. MOCON will be neutral to EPS in 2017. It's about a $70 million revenue deal. It's an outstanding company. MOCON has a very strong niche position in gas analysis instrumentation. It's a leading brand, very strong technology intellectual property position. Strong growth profile. It's been a mid-single-digit grower in a noncyclical market. Solid aftermarket mix. So it checks a lot of our boxes, and we're very pleased with the acquisition. But, again, it will be neutral to EPS in 2017.

Bhupender Singh Bohra - *Jefferies LLC, Research Division - Equity Analyst*

Okay, got it. And I just wanted to get a roundup on geographical region, Dave, as usual?

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

Yes. The U.S. was up 1%, so it continued improving sequential trend. You'll recall, the Q3 '16, it was a negative double digits and then in Q4, it went to negative 2%. Q1, it was flat and Q2 was plus 1%. So it continued that sequential improvement in orders and sales. But the one thing that we're encouraged with, orders were very strong, in line with the overall company orders. So we saw a significant change in orders in the U.S. Europe was up 6%, in line with recent trends, and it was broad-based. Notable strength in our Process businesses. Our Dunkermotoren business continued to perform very strong. The Middle East was very strong for us, and it resulted in a lot of strength in Europe. Asia performed very well, up 10%, driven by strength in our analytical instruments business. China was up 11%, so that's 2 quarters in a row where China has been very strong. Japan, up 9%. India was up 40%. It's a smaller part of AMETEK, but very strong orders growth. So really, when you look across the globe, Bhupender, all regions or all major regions were improving, and orders were ahead of sales. So we feel good about that.

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*

Could you guys talk a little bit about incrementals in the back half of 2017? If I remember correctly, the oil and gas and metals business typically carries higher incrementals. I mean, should we assume that? Or is there some mix issues in the back half?

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

Yes, we have some mix issues but -- that we talked about earlier in the year. But with the EIG core margins up 50 bps and EMG core margins up 60 bps, we feel pretty good about the second half of the year. So we've -- overall for the business, we had incrementals of 30% in Q2. So about the same as Q1. So -- and we said that we'd be up in incrementals from 20 to 60 bps for the year. So we feel we're performing very well, we're getting the pull-through on the incremental volume, and I would expect it to continue at the same level it is.

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

That's great. And then, obviously, oil stabilizing sort of this $45, maybe $55 range. As you -- you look to the sustainability of that business for you, are there any concerns, any sort of pullback that you're seeing in inquiries? Can you just talk about, maybe, customer dynamics sort of in this range of -- and maybe for the next 12 months here?

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

Yes, we feel really good about it. What we're seeing is -- we make manufactured capital equipment. So there was some excess capacity in the market that needed to be utilized, but we're seeing increased activity. We're seeing it in the upstream market. As I said before, up high single digits. We're seeing strong aftermarket MRO business across the globe. The mid- and downstream market, we were calling that maybe down this year to flat into flat. We're feeling more confident because we booked some significant project business in the Middle East. We had some businesses that were not penetrated in the Middle East. We made some investments, and we booked some substantial project business. So that project business kind of takes the risk off the table from my viewpoint for midstream and downstream for the balance of the year. So we feel pretty good about it. We didn't get ahead of ourself, and we're still accelerating.

Operator

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

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

Congratulations on the quarter and a good start to the year. Although, not entirely surprised, I suppose. I guess, the first question I would have is maybe you could just kind of give us the latest kind of state of your balance sheet -- balance sheet capacity, complexion of deals you're looking at, size and scope, so we just have a good sense of, kind of, what your M&A firepower is over the next 12 to 24 months.

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

Right, right. I think Bill might have mentioned before that when you take the cash and the existing credit facilities, there's about $1.5 billion of firepower there. But more importantly is the operating cash flow of the business. We're going to generate about $800 million of operating cash flow. It's a CapEx-lighter and asset-light business model. So we'll spend about 1.8% or 1.9% of sales, about $80 million on CapEx. So that leaves $720 million of free cash flow to deploy on acquisitions. And we've already deployed about $520 million on MOCON and Rauland. So really, not constrained with our current strategy with our balance sheet. A lot of optionality and a lot of firepower. You talked about the M&A pipeline. Our pipeline remains active. We're very excited about the quality and breadth of our deal pipeline. As we said before, we have a dedicated team of about 10 M&A professionals who work closely with our businesses to identify strategic acquisitions. We're in a lot of niche markets, and this allows for a broad set of opportunities from which we can identify the best fit. So it allows us to remain disciplined in our return metrics, and we select the deals that we had the most synergy to. So we have excellent capability in the deal sourcing and the whole M&A team from deal sourcing, deal modeling, diligence, integration and very bullish on M&A and very bullish on the future of -- for AMETEK.

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

And just a couple more. On the oil and gas exposure, could you just give us some sense of your business in terms of the sizing now? And then, specifically, just given the oil and gas from what we've seen, I mean, how should we get concerned if we see oil pull back again versus maybe some structural or comp-aided, led recovery here? Meaning basically, could we be in a situation where you expect to see line of sight to low to mid-single-digit growth well into '18 despite what we can see in normal variations in the price oil?

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

Yes, we haven't talked about 2018 yet. But, certainly, we've already booked some orders for 2018, those large projects in the Middle East that I talked about 2 quarters in a row. And we think the price of oil on that $45 to $50 range is fine. It allows us to -- we have very differentiated products. We have a captive aftermarket. That aftermarket is about 1/3 of the business. The business is geography -- geographically dispersed: about 1/3 in the U.S., 2/3 internationally. And during the downturn, we continue to invest in our market position. So we feel really good about it. We're not expecting it to turn into the gung-ho times of the past. At that time, it was about $400 million in revenue for AMETEK. And now it's about $240 million of sales entering 2017. So it's about 6% of the company, 20% upstream, 40% -- 80% mid- and downstream. So 20% upstream, 80% mid- and downstream. And at the current price of oil, we're seeing increased activities. Our customers are talking to us about orders. The -- they have capital spend. The authority is for -- to spend is back in the business units instead of the C suite. And we had some modest expectations coming into the year, and we feel solid that we're going to achieve them or beat them.

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

And then just last, more of an editorial comment, I mean, have you looked at it potentially -- a lot of your competitors are or have moved to -- or not competitors but public comparables, I suppose, have moved to looking at kind of cash earnings just given the nature of their business models and the compounding kind of M&A business model, which is similar to yours, obviously. Have you looked at that? And just in the context of just your strong operating and free cash flow generation.

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

Right, we do have tremendous free cash flow generation. And if we reported EBITDA, it would add [4] points or so to our earnings. And -- but we haven't made a decision, and we're not looking at changing it right now. So at this point, we figure you're smart enough to figure that out and we're -- we have a GAAP quarter. GAAP 2018 -- GAAP 2017 and versus GAAP in 2016. So -- but we have noted that we are getting increased questions, but we really haven't looked at it in detail then we haven't made a decision to move to that by any means.

Operator

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

Deane Michael Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

I have got a question for Bill on the working capital improvement. Just -- are you targeting a specific working capital to sales? Where are the improvements coming from? And how are you getting there?

William Joseph Burke - *AMETEK, Inc. - CFO, EVP and Treasurer*

Yes, I think we're pleased with where we were at 17.9%. I think we've been as low, in the past is in the mid- to low 17s. I think that'd be a good place for us to get to again, and we're certainly working towards that. I think the area of our greatest opportunity, and we did see improvement in that this quarter, is around inventories. But we continue to push on all facets, both receivables as well as payables in addition to inventory. But I think when you look at our company, inventories are the greatest area of opportunity, if you will.

Deane Michael Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

Got it. And then, how about pension? And you made the contribution last quarter. What's the status?

William Joseph Burke - *AMETEK, Inc. - CFO, EVP and Treasurer*

Plan is performing very well. We're about 110% funded domestically. Internationally, in the U.K., we're a little bit underfunded, around 90%. So from that perspective, our plans are fully -- on an overall basis, very well funded. Returns of the plan have been very good this year -- year-to-date as you'd expect, given the state of markets around the world. So we're very comfortable with our fundings around their pension plans, and at this point, wouldn't expect any further fundings other than the small numbers that need to go in on a regular basis into the U.K. plans, but nothing of significance.

Operator

Your next question comes from the line of Andrew Obin with Bank of America Merrill Lynch.

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

Just a question about second half. As I looked at your change in your organic top line growth and I just looked at the change in EPS and if I do sort of basic calculation on incrementals for the second half, are there any headwinds in the second half? Sort of, I guess, it's the continuation of operating leverage question in the second half. But are there any issues related to M&A? Or onetime charges in the second half that we should consider thinking about EPS?

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

No, no, not really. When you look at the second half of the year, the simple economics are we raised our organic sales growth from low single digits to low to mid-single digits. So that's roughly a $60 million increase. And if we get a 30% pull-through, that gives you about $18 million, and that's about $0.05 cents or $0.06. So that's the economics of it very simply so...

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

Right, and then I sort of took into consideration what you guys did this quarter. Maybe I am nitpicking, right?

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

Right. And we do expect the organic growth for the second half of the year to be a lot like the first half, with Q4 a bit stronger than Q3.

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

Okay, got you, so the same math. Just a question on visibility. How much visibility do you have in China? You sort of highlighted strong orders there. But do you think you have visibility into next spring after this big party congress that they're going to have?

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

Yes, we haven't done any planning for 2018 yet, and we're still focused on 2017. And for 2017, we have solid visibility for the remainder of the year. China looks like it's going to be strong for us.

Operator

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

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

Just one question on your Aerospace business. Longer -- more longer-term question. So when you see Boeing starting to in-source and create an avionics department and then -- how does that make you -- how do you think about your existing business in light of that kind of trend? And how does it make you -- does it make you want to think about your positioning longer term differently than you would have a little while ago?

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

Not, it doesn't. I mean, if -- we're at a place on the value chain in the Aerospace industry where, from my view, it's the place to be. We're not at the system integrator level selling to Boeing. We're down on the -- to the differentiated components. And typically, when we do some type of electronics, it's typically around our unique sensing technology to put together a subsystem for a person that's a system integrator. So I don't -- the types of work that we have is driven by our sensor technology, which is proprietary. And also the projects that we get involved at, I don't think it will have any effect with Boeing creating the avionics business unit. They may have a bigger effect upstream from us at the system integrator level, but it won't affect our business.

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

Okay. And then just to kind of follow on Andrew's question earlier on the guide. I know you're probably beating a dead horse here a bit. But the $0.05 guide -- bump at the midpoint off of a $0.04 beat to your 2Q plus with FX moving in your direction, just what other (inaudible) costs that we need to think about? Is it with the organic raise in the FX and the beat here, it sums to more than the magnitude of raise. So what do you look at, at the offsets there?

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

Yes, the one offset will be the continuing compensation in the quarters that we dealt with the first half of the year. But we're executing very well, and we have a high degree of confidence in our outlook. And as you said, we did raise our guidance for $0.05 at the midpoint, and it was more than our beat for the quarter. So there may be a bit of conservatism. We feel very good about how the year is playing out.

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

Okay, and then if can just -- on EMG specifically, incrementals there looked a little bit lighter just given the magnitude of the organic growth in the quarter. Is there anything specific in the quarter you can point to there?

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

No, EMG's incrementals are a little bit lower than EIG's so there isn't anything that's notable there.

Operator

And our next question comes from the line of Ken Newman with KeyBanc Capital.

Kenneth H. Newman - *KeyBanc Capital Markets Inc., Research Division - Associate*

Just wanted to see if you can give some color on your aftermarket or unit businesses versus OE. Just curious if you're seeing normal -- where the units on the cycles.

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

Right, in the Aerospace part, our third-party MRO business, we expect solid low to mid-single digit growth for the year. Those businesses are very steady businesses, they're doing very well, and we have some niches that are (inaudible) right now. So we feel really good about that. And the balance of AMETEK, non-Aerospace, we have largely proprietary aftermarkets tied to our spare parts and services of our equipment. So that's captive and it's growing very well.

Operator

And that concludes our Q&A session for today. So with that, I would like to turn the call back over to Vice President of Investor Relations, Kevin Coleman.

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

Great, thank you, Andrew. Thank you, everyone, for joining our call today. And as a reminder, a replay of the call will be webcast and access -- can be accessed on our Investors section of ametek.com. Thanks, and have a great day.

Operator

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