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Dover Corp. (DOV)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Dover's Second Quarter 2024 Earnings Conference Call. Speaking today are Richard J. Tobin, President and Chief Executive Officer; Brad Cerepak, Senior Vice President and Chief Financial Officer; and Jack Dickens, Senior Director, Investor Relations. After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions]

As a reminder, ladies and gentlemen, this conference call is being recorded and your participation implies consent to our recording of this call. If you do not agree with these terms, please disconnect at this time. Thank you.

I would now like to turn the call over to Mr. Jack Dickens. Please go ahead, sir.

Jack Dickens

Senior Director-Investor Relations, Dover Corp.

Thank you, Jamie. Good morning, everyone, and thank you for joining our call. An audio version of this call will be available on our website through August 15, and a replay link of the webcast will be archived for 90 days. Our comments today will include forward-looking statements based on current expectations, actual results and events could differ from those statements due to a number of risks and uncertainties, which are discussed in our SEC filings. We assume no obligation to update our forward-looking statements.

With that, I will turn the call over to Rich.

Richard Joseph Tobin

Chairman, President & Chief Executive Officer, Dover Corp.

Thanks, Jack. I'm on slide 3. Second quarter results were solid, driven by excellent production and shipment performance against our order book. Strong revenue performance was broad-based across our end market and geographic exposures, with four out of five segments posting top line growth.

Organic revenue was up 5% for the quarter. Bookings were up 16% organically year-over-year, continuing their upward trajectory over the last several quarters and bolstering our confidence in our second half outlook. Margin performance was excellent, up 200 basis points over the prior year to 22.1%, driven by volume leverage, organic and inorganic mix, proactive cost management, and rigorous productivity actions.

Our strong operational results were complemented by ongoing portfolio evolution actions. Over the last week, we have completed two strategic bolt on acquisitions, enhancing our clean energy components platform, adding applications in highly attractive end markets, expanding our global reach, and strategically expanding our manufacturing base into new regions.

We also recently announced the sale of our Environmental Services Group (sic) [Environmental Solutions Group] (00:02:40) business unit for $2 billion in cash. This transaction, together with the sale of De-Sta-Co in March of this year, reflects our intention to reduce our exposure to capital goods. We have monetized these businesses where we have material improved operating performance at attractive exit multiples, while methodically migrating our portfolio toward higher organic growth and margin opportunities.

We are approaching the second half of the year constructively. The underlying end market demand is healthy and is supported by our sustained order rates. We are, therefore, raising our adjusted EPS guidance to $9.05 to $9.20.

I'll skip to slide 4. Engineered Products had another robust quarter, driven particularly strong volume growth and conversion of waste handling and aerospace and defense. Volumes of vehicle aftermarket grew in recovering European market conditions and improved production performance. We expect volumes to remain strong for the segment through 2024. Margin performance was solid in the quarter on strong volume conversion, favorable mix, and productivity.

Clean Energy & Fueling was up 2% organically in the quarter on solid volumes in clean energy components, where we are starting to see robust quoting activity and order rate momentum from component parts tied to large projects in hydrogen and cryogenic applications. Volumes were also solid in software systems, and above-ground retail fueling continued its positive recovery, particularly in the US. Margins were flat in the quarter, as proactive cost curtailment offset volumes and mix.

Imaging & ID posted an excellent quarter on growth in serialization software and strong shipments from marketing – marking and coding consumables and aftermarket parts. Printer shipments were still subdued, improved sequentially, and should inflect positively in the second half. Margin performance was exemplary on SG&A leverage and a higher mix of consumables and aftermarket shipments.

Pumps & Process Solutions was down organically, as expected, principally due to lower shipments in our long-cycle polymer processing business. Partially offsetting these headwinds were significant growth in shipments and new bookings for thermal connectors tied to AI chip liquid cooling applications and data centers, as well as a solid quarter in precision components. Both orders and shipments of single-use biopharma components grew sequentially and year-over-year continuing to post-COVID recovery. Margins in the segment were up on mix and operational execution.

Top line performance in Climate & Sustainability Technologies have outperformed our internal estimates due to an exceptional quarter in food retail, which nearly offset the capital investment slowdown in beverage can making and impact of destocking headwinds in the broader HVAC complex, most notably in European residential heat pumps on our European brazed plate heat exchanger business. We expect these headwinds to persist in the second half, with heat pump-related shipments troughing in the third quarter. Margin performance was exceptional, driven particularly by food retail, which posted all-time record margin in the quarter on strong volume conversion and a greater mix of CO_2 systems shipments.

I'll pass it to Brad here.

Brad M. Cerepak

Senior Vice President & Chief Financial Officer, Dover Corp.

Okay. I'm on slide 6. The top bridge shows our organic revenue growth of 5%. The De-Sta-Co sale, which was closed on March 31, more than offset acquisition-related revenue of – by $9 million, while FX was a headwind of approximately $13 million. From a geographic perspective, the US, our largest market, was up 11% in the quarter on solid broad-based activity with particular strength in waste handling and food retail. Europe and all of Asia was down 4% and 9%, respectively. China, which represents half our revenue base in Asia, was down 8% organically in the quarter, primarily due to shipment timing within polymer processing.

On the bottom of the chart, bookings were up year-over-year. Of note, orders were also marginally up sequentially on an organic basis quarter-to-quarter. Below-the-line items negatively impacted our earnings in the quarter, driven by a higher tax rate, as well as higher corporate costs net of interest, due in part to elevated deal expenses.

Now on our cash flow statement, slide 7. Adjusting for taxes paid on the gain De-Sta-Co, which are non-operational in nature, our free cash flow came in at 10% of revenue in the quarter, up $64 million year-over-year. Year-to-date adjusted free cash flow is essentially flat versus the prior period despite investments in working capital due to shipment timing driving higher receivable balances, as well as investments in inventory due to strong bookings rates.

We expect to materially liquidate our working capital balances over the second half of the year and are on track to deliver our full year adjusted free cash flow guidance of 13% to 15% revenue.

I'll turn it back to Rich.

Richard Joseph Tobin

Chairman, President & Chief Executive Officer, Dover Corp.

Thanks, Brad. I'm on slide 8. Here, we provide some visibility into the contribution of the portfolio of both the ESG divestiture and the recently closed acquisitions in clean energy components providers, Marshall Excelsior and Demaco. These transactions continue our purposeful portfolio migration away from capital goods towards higher gross margin, less cyclical, and higher growth component businesses that serve secular advantaged end markets.

We have been methodical and disciplined in our approach to enhancing the portfolio through acquisitions, and patient in our strategic divestitures. We are pleased with the valuations of our two recent divestitures within Engineered Products' ESG announced on Monday and De-Sta-Co which closed in March, that both achieved above 13 times trailing EBITDA multiples, significant premiums for capital goods assets.

The transaction details are on the page. Due to the timing of the ESG signing and uncertainty of the closing date, we have left ESG in our full year guidance for now. We expect to move ESG to discontinued ops in Q3 earnings report, and will recast our historical financials and guidance at that time. The ESG earnings profile is shown on the page. And importantly, we're not including any benefit of the transaction proceeds toward value-added capital deployment.

We believe we are entering a 12 to 18-month period that represents a unique buying opportunity for attractive assets, including many private equity-owned businesses that are overdue for exits in our highest priority areas of inorganic expansion. Our current balance sheet strength and cash flow forecast, reinforced by the proceeds of ESG divestiture, position us well to remain on the front foot in pursuit of attractive capital deployment opportunities.

Let's go to slide 9. I wanted to provide a little more color on our collection of businesses that provide critical flow control and safety components for industrial gas, cryogenics, natural gas and clean energy applications. These businesses expand across both our Pumps & Process Solutions and Clean Energy & Fueling segments, so there is significant commonality in industrial tailwinds and business models. These businesses provide highly engineered components that serve demanding applications in the broader clean energy and industrial gas complexes, and there are growing requirements for sustainability, emissions reduction, and safety that create favorable product loyalty dynamics and innovation opportunities for us.

Our positions in these attractive markets are supported by strong and recognized technological and application expertise and intellectual property with large installed bases that drive reoccurring replacement demand, as well as exposure to high-growth uses like hydrogen and LNG. We have been active acquirers in the space, investing roughly $2 billion over the last several years. We believe these investments should generate mid- to high-digit growth at margins accretive to current – our consolidated portfolio over the long run. This remains a high priority area investment for us moving forward.

In light of our recent divestitures, with the scale of this critical component platform now reaching $1 billion of revenue, we intend to re-address our current segment structure in the near future to add focus and disclosures around our growth platforms.

Slide 10 provides a little bit more color on Marshall Excelsior, the larger of the two energy businesses that we've carved in the last week. MEC's acquisition broadens our portfolio in cryogenic valves and other components, and expands our participation in several applications, including the expansion into remote monitoring and digital controls in cryogenic transport and severe duty valves, providing an excellent opportunity for cross-selling.

Integrating MEC in to our existing clean energy platforms and centralized support functions should provide significant cost savings. We expect to capture about $12 million in run rate synergies, driving MEC to high 20s margin and high-single digit ROIC by year three.

Taking a step back shows the broad scope of our offering within clean energy applications. We're supplying a variety of safety-critical components like valves, regulators, nozzles, loading arms, dispensing and gas handling equipment for a variety of applications across the high – the whole cryogenic gas value chain from production to consumption.

We serve both gas and liquefied gas applications with multiple molecules handled, including LNG, hydrogen, propane, oxygen, and nitrogen, among others; and we're benefiting from strong investment momentum by industrial gas majors and global government infrastructure spending. While a smaller deal for us, Demaco was also closed last week, providing us the very important European base of manufacturing to enhance our growth and global scale.

Finally, on slide 12 shows the long-term performance of the portfolio. We continued to deliver earnings growth through a combination of top line organic growth, margin improvement through operational execution, and returns on productive capital deployment strategies to methodically improve our portfolio over time. Our strong balance sheet position will be further enhanced by the proceeds of the ESG divestiture in the second half of the year. We expect to end the year with approximately $3 billion in capital deployment firepower from cash and reasonable leverage levels. We have a number of levers available to deliver the second half with a flexible business model that can quickly respond to changes in our dynamic markets.

I'd like to end by thanking ESG President, Pat Carroll, and his entire management team for the value they created for Dover's shareholders under their tenure.

With that, let's go to Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We ask that participants limit themselves to one question and one follow up question. We'll go first to Andy Kaplowitz with Citigroup. Your line is open.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Great. Can you hear me okay?

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.
A

Hi, Andy. Good morning.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.
A

Yeah, we hear you, Andy. Go ahead.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Hey, Rich. Maybe you could talk about bookings cadence during the quarter and how you're thinking about bookings growth going forward? Do you still see book-to-bill over 1 times for the rest of the year? And then, as I'm sure you know, short-cycle markets seem over the place at best. So, what are you seeing macro-wise and would you say that Dover's outperformance is really a result of Dover's unique exposures versus a lot of macro improvement?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.
A

Yeah, I would expect it to be over 1. As you know, I think that our comps are easier in the second half of the year from an order basis. It's been a little bit lumpy, I have to say, intra-quarter. So, we'll see how it goes. But our expectation is to be over 1 for the balance of the year, and I think that's reflected if you take a look at our full year forecast in terms of revenue growth and everything else.

The outperformance, look, I mean, I think, at the end of the day, we led in, we led it out, and we're probably leading in again. So, as we've discussed previously, I think that our inventory positions are well-placed and some of the markets that we have exposure to that have suffered over the previous 24 months are making a turn. We add on top of that some of growth platforms like we have, like thermal connectors and CO_2 systems, which are performing very nicely. So, I don't – I think it's – I'll step away from the rest of our competitors in macro. I just think it's unique to our portfolio.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Maybe just following up on the last comment, Rich, can you give us a little more color what's going on in DCST? Obviously, you just mentioned CO_2 systems, food retail in general is driving the outperformance. But how's it trending versus your original expectations for the year? Does the strength in food retail actually more than offset the continued weakness in heat exchangers to end up leading the upside in that segment?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Yeah. Look, I think that when Belvac was well known going into the year, and that was part of our plans, I think there was a lot of mixed signals around heat exchangers. I think we've done a lot of work there. That's why I think that we're pretty confident to call the trough in Q3, and we would expect order rates actually to move up hopefully at the end of Q3, but clearly into Q4.

I think on the food retail business, I think that CO_2 is doing pretty much as planned. I think that what's doing better than planned is the margin performance of the business has just been exemplary through the quarter. So that's why when you look at the consolidated results, I don't think that we would've expected food retail to offset the margin deletion from heat exchanges. But during the quarter, it did, which has been excellent.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Appreciate the color.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: We'll go now to Jeff Sprague with Vertical Research Partners.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Hey. Thank you. Good morning, everyone.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Hi, Jeff.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Hey. Hey, Rich. Just thinking about slide 11 and everything you've kind of done here on gas and cryo and everything. You're characterizing it as kind of a component-driven strategy, and I get that margins are often very, very good in components. But it looks like you're also stitching it together with some automation and some other things. So, maybe just kind of talk about what else, if anything, you need or want to do here as we think about another $3 billion in capital to deploy. Is it sort of all in the same ZIP Code or are there other kind of M&A vectors we got to be thinking about?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Yeah. I'm hesitant to say – well, a couple of things, Jeff. What we're going to do, whether it's before the end of the year or very early in next year, I think you heard from my comments that we're intending to re-segment and to give some more visibility here. When we do that, we're going to make an investor presentation. I'm loath to say we're interested in because this area has gotten some intention. So, in an area that over the last previous couple of years where we've been a buyer, now we've got some competition in this space. So, I guess, I'll take a pass on saying what we'd like to do in the future because I'm not interested in attracting any more interest there.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

And then, one of the things we've seen out of Dover, though, Rich, also is when you put these stakes in the ground, you turn it up organically. I mean, with your kind of flow and other competencies here, is there sort of a lot you can do organically to kind of expand your scope here or it would be mostly an M&A-driven strategy?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.
A

Two – there's two strategies here. I think, as I mentioned in the comments, we believe within 24 months we can get this entire cluster of businesses, some of which are already performing here, but the entire cluster, up into mid-20s EBITDA margin. And that'll be through, number one, we think it's a growing area so we're going to get some volume leverage there. But I think once we put the – our Dover playbook on back-office integration and all the things that you know about, I think that within 18, 24 months, we can drive the entire segment up there.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

Yeah, [ph] all right (00:20:50). And just a quick one on this whole heap pump question. Were you talking about Europe specifically, the whole business broadly, the bottom in your business or it's the bottom then your customers' business, that whole kind of lead/lag equation everybody's been trying to sort out?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.
A

Yeah. Yeah. Well, it's unfortunate that we were all never aligned between the components manufacturers and the end market. But the fact of the matter is we've – like I said in the comments, we've spent a lot of time on trying to determine total inventory in the chain. We believe that the – and it's mostly European heat pumps because that's the vast majority of the volume in the first place. Heat pumps North America and then the balance of the world proportionately is relatively small. So, we think that we trough in terms of volume in Q3. And our expectation, based on discussions we have with our customers, that inventory has been flushed and will go back to positive orders in Q4.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

Great. Thanks for the color.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.
A

Thanks.

Operator: We'll go now to Steve Tusa with JPMorgan.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Hi, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So, as far as the orders are concerned, can you just give us some – I missed the first [ph] call (00:22:14) minutes of the call, so you may have said this, but just some color on how you expect them to trend sequentially? And then, should we expect normal seasonality off of that in the fourth quarter?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Look, I think that book-to-bill should remain 1 or higher for the balance of the year. I think that we have – in Q2, I think we actually did a little bit better than I would've expected in terms of production performance in the shipment, and that's why it drove the 5% organic growth, and that's – that changes the metric, but I think that the order rates, we got a good handle on. I think that we stay above 1 for the balance of the year.

Q4 generally is going to be a proxy on everybody's macro outlook of 2025. But as I said before, I think that we roll into some easier comps then, and something like SWEP should turn positive finally in Q4 if not at the end of Q3. And I think the momentum that we're going to have in thermal, biopharma, the momentum we have in CO_2, all will contribute to staying above 1.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. And then, just in the quarter, I know you guys had said flat sequentially. You were down a little bit. I know that's kind of nitpicking, but what was the – what was slower for you guys in that orders, just the one or two things that that held back a bit?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

You know what, Steve, I'd have to go through it. I'm sure that somebody took some outsized big orders in Q2 of the previous comparable. I'd have to go dig through it. I'll get Jack to follow up.

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Yeah. What we said, organically, it was sequentially up marginally. So, you got to take into effect the disposition of De-Sta-Co, the acquisition timing within quarter, and also FX, which was higher than we expected in the quarter, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah, got it. Okay. Makes a lot of sense. Thank you.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: We'll go now to Andrew Obin with Bank of America.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Hi, guys. Good morning.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Hi.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah, just a question about sort of acquisitions. You're sort of increasing your exposure to green energy, but I think our sense is that, at least for now, a lot of these orders are being – not orders, just a lot of these projects have been pushed out over regulations, sort of visibility on taxes, visibility on funding. I mean, clearly, it's an informed bet. And I think in May at our event in New York, we definitely talked about that quotation activity is very, very robust. Can you just talk about what it is you're seeing over the next 12 to 24 months that makes you commit capital to this sector? And to make it clear, we're quite excited about it, but it does seem that, near term, there are some push outs. Just give us your view because you tend to think about these things. Thank you.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Yeah. I mean, Andrew, look, I mean, at the end of the day, you can't – when the market's there, it's too late to buy anything, right? So, you need to basically take some bets on what you think has got secular growth behind it. So, if we think about thematics at the end of the day, I mean, there's a whole stream of electrification. We're not chasing that meaningfully. We've had a presence in the gas sector for decades. So, we know the customers, we know the regulatory environment around it and everything else. So, we're big believers in – the electricity has got to come from somewhere, and we're big believers that the total gas complex is going to be an important contributor there.

What we're buying are large installed bases at the end of the day. So, we're not paying on the [ph] comp (00:26:17) to a certain extent. But cryogenic components and vacuum jacketed piping were kind of niche-y businesses in the past, but to the extent that cryogenic gas applications continues to expand, we would expand. We're mixed, we're buying these things and we're expanding capacity on top of them as we do it. So, if we get the timing off a little bit, so be it, at the end of the day, I think. But from a secular point of view, we're pretty confident of what we're doing.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

All right. Got you. And maybe a little bit more color on what you're seeing on DPPS? Right, you're sort of highlighting a year-over-year growth in biopharma. And then, clearly, I think you're sort of talking about thermal connections. So, what kind of growth can we think about – just two-part question. What kind of growth can we think about thermal connections? Can this business actually double over the next 12 months? And second, on biopharma, when do we actually start growing year-over-year? Thank you.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Well, we should grow year-over-year right this year, considering we probably bottomed at the – in the mid to late of 2023, so that's good news. And on the thermal, look, it's a small base but, at the end of the day, our bookings are up significantly and we would expect total revenue and earnings to be on target to what I think I gave you some numbers at the end of [ph] Q2 (00:27:52) when we're tracking that way.

I believe that thermal is going to be interesting, right, because back to your question before between all the hype of everybody talking about it and then the lag period, I think that we're on the front foot for production capacity. I think that we've got clean room production capacity. I think that we're going to be able to have 100% traceability by the end of the year, which should separate us from a lot of people that are going to try to get into this business.

So, if I step back at DPPS, in total, we knew that MAAG was cycled down after a three-, four-year run coming up. Industrial pumps is, I would call it, not robust right now, but that has been offset by precision components, which is really part of the exposure that we've got into the gas complex and the mix effect of both biopharma and thermal connectors.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Thank you very much.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: We'll go next to Scott Davis with Milus Research (sic) [Melius Research] (00:28:57).

Scott Reed Davis
Analyst, Melius Research LLC

Q

Hey, good morning, Rich and Brad.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Hey, Scott.

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Good morning.

Scott Reed Davis
Analyst, Melius Research LLC

Q

I wanted to go back to, I think, the second [ph] road (00:29:09) of Jeff's question really on slide 11. Are there channel synergies? Are there synergies that are kind of tangible? When you just look at the assets on this page, what – or is it just commonality of end markets? Are there actually some tangible synergies and benefits of bringing them all together under one segment?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Yeah, I mean, sure.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Assuming you do [indiscernible] (00:29:34)...

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Yeah. I mean, we bought RegO and Acme at the end of 2021. So, MEC, basically, is an overlap adjacency to that – to those prior period acquisitions, so it's just – think about just adding a bunch of new products under a footprint that we already have. There is a manufacturing footprint opportunity there, clearly, both inbound and reverse synergy on the footprint. These are global businesses.

So, part of the reason that we did Demaco is you just can't say I'm a North American provider, you have to have – when you're dealing with companies like Linde, you need a European presence. So, that's why we purchased Demaco is to kind of make our presence in Europe larger at the end of the day. And so, what we're kind of building, a lot of the times, they're the same customer; a lot of the times, they're adjacencies. But the regulatory and safety requirements to build those kind of components are very common and it's just an ability that we have.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Okay. And just following up, your bullish M&A comments, I think last quarter was trending in this direction, too. I mean, is it a commentary more on asset availability or valuation or both?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

More asset availability. I mean, look, we've been hearing about it was supposed to be 2023, then it was supposed to be 2024, and now it's – we're beginning to see assets coming out of PE, but our expectation is the process is going to accelerate. I think everybody's been waiting for an interest rate cut to kind of flex it. I mean, the equity markets have been doing relatively well, and that is helpful in terms – not to us in terms of buying, but it's helpful for exit from a PE point of view.

So, we've been kind waiting for this opportunity for a couple of years now, and I think that we're kind of bullish that we'll see if we get them done, all right? We're going to not start throwing money around like drunken sailors, but I think that we're on the front foot of – we think there's going to be a lot of opportunity going forward. And now, with the monetization of ESG, we're a cash buyer. So, that puts us in a good spot.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Yeah. Good luck. Thank you.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: We'll hear next from Brett Linzey with Mizuho.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Hi. Good morning, all.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Good morning.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Hey, just – yeah, just wanted to come back to the ESG divestiture. So, you called out $1 of dilution to the adjusted EPS on slide 8. You have announced a couple of deals here. How are you thinking about the backfill? Do you have line of sight to more than offset with M&A or should we think about a balance of repo in M&A?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

I think that our bias would be towards M&A. But I think we've got a history of we don't sit on cash for a prolonged period of time. The good news now is, unlike a couple of years ago, we actually get some yield off our cash. If we wind the clock back, cash three years ago, we got nothing for it. So, yields right now on cash balances, let's just call it 5% or so. That's not bad. So, we can be a little bit more patient, if you will. And if you heard me answer the last question, we think there's going to be a lot of M&A opportunity coming forward. So, I think our bias is probably a lot more towards M&A than share repurchase than it's been over the previous three to four years.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Okay. Great. And then, just a follow up on free cash flow. So, thinking about the composition of ESG out, some of these more recurring businesses into the mix, how should we think about free cash flow margin as you evolve the portfolio and you're buying more recurring cash flow?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Well, I mean, like the ESG actually from a working capital point of view is a pretty good performer. But – so the benefit would be on the gross margin, right? So what we're bringing in gross margin up, so profitability up. So, the like-for-like swap of dollar of revenue should be better from a cash [indiscernible] (00:33:59).

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Should be better, yeah.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Great. Good quarter. Thanks.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: Next, we'll hear from Julian Mitchell with Barclays.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. One segment that doesn't get a lot of airtime is DII, but it had very impressive bookings, organic sales growth, margin performance in Q2. And I suppose on the revenue front, a good turnaround year-on-year from what happened second half of last year and into Q1 of this year. So, I'm just trying to understand the growth drivers there. And again, comps are pretty easy in the second half and the – on sales and the bookings growth was good in Q2. So, just trying to understand kind of how strong could that growth be in the back half? And realize those incrementals are exceptional to a degree with mix, but should we see at least very strong incrementals again in the second half?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Yeah. That's hard to say, right? I think, at the end of the day, you have a pretty strong mix effect in Q2, right, because of consumables being proportionately higher than kind of average. I mean, printer shipments actually dilute margins at the end of the day, so their per dollar shipment value is higher but the margin dollars per revenue comes down a little bit.

Look, we're really happy with the margin performance. This business, over the [indiscernible] (00:35:42), is a steady eddy. I think the management's done a great job of moving the margin up through more or less efficiency, more than anything else. So, we'd expect that to continue. But I wouldn't be surprised if you saw a little bit of margin dilution in the second half, especially if printer shipments move up proportionally to the consumables.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Thanks. And then, just – I know you don't give much -understandably, you don't give much color on the sort of quarterly cadence of earnings, but the – we're halfway through the year and the seasonality's been confusing in recent years. So, I just wondered sort of, when we think about third and fourth quarter total Dover earnings sequentially, if you like, is it sort of Q3 up a bit sequentially on earnings and then down sequentially in Q4? Is that the way to think about it?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Yeah, well, the way we think about it is Q1, Q2 and Q3 tend to be up, and then Q4 usually is a flex quarter and it depends on order rates and whether we drive for cash or we're really bullish on 2025 and whether we build inventory or not in Q4. I would – I think that that kind of sequential performance is going to hold for this year, and that's what we've built into our forecast.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

That's great. Thank you.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: We'll go now to Joe Ritchie with Goldman Sachs.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Good morning.

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Morning.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Joe.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

So, I'm going to start on ESG because, Rich, I guess, I was – maybe I was the only one that was surprised that you guys ended up selling the business. I just thought of it as being a good margin, good return type business. I'm curious kind of what went into that decision as you thought about evaluating that asset over the long term?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

I don't know, Joe, I think that we've been fielding questions on the capital goods portion of our portfolio as long as I've been here. And we had said, [ph] least (00:38:02) initially, that we thought that we could improve the performance of the business, so that we were going to be patient and wait if someone was interested in it then we were going to wait to make sure that we're paid appropriately for it.

I mean, I know that there's lots of different calculations about what we were paid, but the bottom line is, on a, call it, a Q1 exit LTM basis, we got 13 times EBITDA. And I come from capital goods. So, the three premier companies and capital goods in the United States are PACCAR, Deere, and Caterpillar, and look where they trade on an EBITDA multiple basis. So, at that point that we think that we can monetize there, we should because, at the end of the day, from a sum of parts point of view, we get a capital goods multiple in that business.

It's one of our – I don't want to talk the business down because the management team did a phenomenal job in terms of the performance of it, but the bottom line is it's one of our lowest gross margin businesses in the portfolio. So, to the extent that we need to kind of mix up over time and we're paid appropriately, I think that that's the way we look at it.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

That's super helpful. And then, I guess, just my follow up question, and maybe just kind of talking about some of the other longer-cycle pieces of your portfolio, so I'm thinking SWEP, Belvac and MAAG, what's kind of the expectation embedded into guidance for growth for those businesses this year? And is it too early to maybe start talking about 2025 and what those businesses could do?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Look, I think that SWEP have this – the brazed plate heat exchanger, heat pump debate, I think, has been beaten to death at this point. Everybody got very excited. The problem with having exposure to subsidized products, it's great when they're subsidized, it's not so great when they're not subsidized. So, we're just going to have to deal with that.

So, if I take that away and I looked at SWEP over time, we actually don't think that that is a cyclical long-cycle business. We think that that's just a components parts business that just went through a kind of an adoption rate on heat pumps through legislation in Europe that we're not going to apologize for. When the market was there, you seize the market. So, I think once we get through this whole period, which hopefully, knock wood, will be at the end of Q3, that that will just go back to being a non-cyclical asset going forward from here.

MAAG is a little bit more CapEx-driven. Belvac's a little bit more CapEx driven. I will say that MAAG is likely to be less cyclical than it's been in the past because I think the management team has done a really good job opening up the vectors in terms of what we sell, and there's actually a pretty large installed spare parts business there. Belvac's always going to be cyclical, but that's not a tail that's going to wag the dog. It's just not that big in our portfolio.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Great. Super helpful. Thank you.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: We'll hear now from Mike Halloran with Baird.

Michael Patrick Halloran
Analyst, Robert W. Baird & Co., Inc.

Q

Hey. Good morning, everyone.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Hi, Mike.

Michael Patrick Halloran
Analyst, Robert W. Baird & Co., Inc.

Q

So, just one for me, [indiscernible] (00:41:36) two part of this. So, as you think about the short-cycle trends, you talked about some choppiness in the order patterns through the quarter, maybe just talk about how you're thinking about the short-cycle trends? And then, secondarily, if there are any leading indicators in those end markets or product categories where you're seeing signs of concern or inversely – conversely, excuse me, signs of acceleration? Thanks.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

That's – I don't want to march through the entire portfolio. It's just been choppy all year in short-cycle. I think with – the distribution is still digesting higher interest costs. The GDP print today was good, at least for North America. It's not been great out of Europe for a period of time. So, there's a lot of uncertainty of kind of what the catalyst is for demand. So, I think I mentioned in my earlier comments, like intra-quarter volatility of order rates, we have like heart attacks around here week-over-week because it kind of flexes all over the place.

But when you let the tide go out, we're still growing the top line. I think that the areas that we know that are in cyclical down trends, we've got a handle on that. I'd like to see Fueling do better. I think that that's been a little bit slower than we would have expected through the first half. We're going to keep a close eye on order rates there going into the second half. And our expectation is, because we've got easier comps in the second half that, by and large, the hurdle rate for orders isn't Herculean.

Michael Patrick Halloran
Analyst, Robert W. Baird & Co., Inc.

Q

Thanks, Rich.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: We'll go now to Deane Dray with RBC Capital Markets.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning, everyone.

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Morning.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Dean, how are you?

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Hey, Rich, really like seeing this pivot into higher up the technology curve, these critical components that are typically a lower cost of the project. And I know you're not going to kind of reveal exactly the areas that you're moving into, but you did – you characterized ESG divestiture as pivoting away from capital goods. And then, Joe's – your answer to Joe's question, you gave some color there, but there are still lots of capital goods exposures in the portfolio. So, where do you draw the line? What's the timing? You've made lots of margin improvements. You said that was kind of the gating factor. But where do you draw the line and how much change can the organization take at just a given point in time?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

There's nothing that we have to sell, Deane. And we didn't have to sell ESG either, right? And if I go and look on return on invested capital in ESG, it's been great, right, because the earnings were – the earnings improvement's been terrific. It's an older asset. So, you got to always be careful with ROIC because its asset base has been depreciated over a long period of time, so it gets a little bit flatter there.

But I don't want to repeat myself, but we spend an inordinate amount of time here doing our own sum of parts on every piece of this portfolio. So, we've got clear understanding at what hurdle rates are for monetization. But we're not going to window dress the portfolio and sell things at below intrinsic value just to make the gross margin go up by 50 basis points.

So, I can't tell you about the timing. We'll just going to have to be patient and we see where we go from there. I think that that the important issue to understand is that we've got optionality in terms of firepower that a lot of people don't have, meaning that we can lever up on an M&A front and then delever by monetization. That's not what we did here. I think we were just more opportunistic, but that is something that – that's an arrow on our quiver going forward.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's really helpful and thank you for that context. And then, just question for Brad. There's an expectation of working capital improvements in the second half. Can you give us some color there or any specifics? And then, what about the – what should we be thinking about buybacks for the second half?

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Well, I think Rich – just taking the second part of that question first. I think Rich already answered that that in a sense that our priority is around capital deployment to M&A, especially as we move here into the second half with market conditions of available assets that we see. So, I think that's a positive thing for us as we move through the year.

In terms of the trajectory on working capital and cash flow, I mean, really, it's no different than last year when you think about it. I mean, we're on pace with the prior year. We have good line of sight in terms of what we need to do in the back half around inventory and receivables, and it's all highly achievable in the same pattern that we saw last year. So, we have pretty good confidence. We have confidence in the 13% to 15% at this stage.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Thank you.

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Yes.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: And we'll take our final question today from Nigel Coe with Wolfe Research.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Hey, thanks. Thanks [ph] for the meeting (00:47:20), guys. Good morning. Look, I know there's been a lot of questions on the cryogenic kind of strategy. But the Marshall Excelsior deal looks really interesting, and the 10 points of synergies that you called out, kind of got my attention. So, maybe just, Rich, remind us, what sort of growth would you expect the market to kind of compound out for the next three to five years? With this cluster of businesses, do you think can gain share and outgrow that market? And maybe just – I don't know if you can tell us this, but what is the entry margin for the Marshall deal?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Okay. Well, I don't have to remind you about the growth rate because I don't think we ever gave you one.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Look, we're going to give you like – and you may have missed it at the beginning, I think that because we built this platform, our intention is to re-segment it into its own platform. And when do that, we're going to give you a presentation of long-term growth outlook and everything else. I can tell you that the profile of what we've been buying has been around 20% margin. And I think then between synergy value and accelerated growth, we think within 24-month period we can get it to 25% EBITDA margin. So, that's kind of the economics behind that.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Yeah. Sorry, I missed the first part of the call, so I missed that detail.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

No, yeah, no worries.

Nigel Coe
Analyst, Wolfe Research LLC

Q

And 10 points, would that be primarily cost or is it exclusively cost or is there some revenue synergy [ph] there (00:48:50) as well?

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

No revenue synergy. It's all – you've seen us make the presentations before about back-office consolidation and all those things that we have. We've got a whole system that's in place. In this particular case, we actually think we've got some backward integration footprint opportunity here from our legacy businesses. So, those are really the two big pieces.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. Thanks, Rich. And then, just for Brad, just some details on the ESG. So, the discontinuation, is that on a go-forward basis, so that'll be just second half impact or do you have to go back and discontinue for the first half as well? And then, is it – do you have any sense yet on the tax leakage on the deal?

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Yeah. So, as it relates to discontinued ops, it would be all prior periods presented.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay.

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

And so, we will restate everything. Once we get to a point in time here later in the third quarter, we'll be taking a hard look at that, and they probably dropped at that point in time, and you'll see all the restatements filed in advance. So, you have that data in advance. And on tax leakage, you should just assume a normalized US type of tax rate, 21% or so on the leakage.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. Great. Thanks, Brad.

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

Which, by the way, that – it's very possible that that cash tax is, unlike De-Sta-Co, goes out this year. So, we're looking at that timing as well.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. But that wouldn't be in your guide, right, for the free cash flow? That would be...

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

No, no, no.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Right, right. Yeah, yeah.

Brad M. Cerepak
Senior Vice President & Chief Financial Officer, Dover Corp.

A

No, no. We'll handle it the same way we handled De-Sta-Co by adjusting free cash flow.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Okay. Thanks, Brad.

Richard Joseph Tobin
Chairman, President & Chief Executive Officer, Dover Corp.

A

Thanks.

Operator: Thank you, everyone. That concludes our question-and-answer period and Dover's second quarter 2024 earnings conference call. You may now disconnect your line at this time, and everyone have a wonderful day.