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OVERVIEW:

Company reported Segment margin of 20.2%, margin of 7%, cash flow of $348 million.

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PRESENTATION

Operator

Good morning, and welcome to Dover's Second Quarter 2023 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 of Investor Relations. After the speaker's 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

Thank you, Shelby. 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 - *Dover Corporation - President, CEO & Director*

Thanks, Jack. Let's start on Slide 3. Our results are in line with our internal forecast in the second quarter. Our secular growth exposed businesses that we highlighted at our recent Investor Day outperformed in the quarter with heat exchangers, natural refrigerant systems and polymer processing, all posting growth in excess of 20%.

During the quarter, we incurred operational headwinds from our vehicle service group main production facility as a result of an ERP implementation, which cost us approximately $50 million in revenue and approximately $0.10 of EPS. This one's on me. The business has been doing an excellent job on efficiency actions related to fixed costs, SKU management and vertical integration over the past 18 months, which has been reflected in the margin performance conducting a much-needed ERP upgrade, which is fundamental to our e-commerce ambitions, while finishing a large CapEx project was in retrospect overly ambitious. And I guess I should have known better.

We exited June -- the good news, we exited June with far improved production performance at the site, and we'll try our best to claw back the lost volumes in the second half. We have a constructive outlook for the second half of the year and are narrowing our annual EPS guidance to $8.85 to $9. Since the start of the year, we expected 2023 performance to be weighted to the second half due to post-pandemic destocking across the industrial economy and the gradual recovery in several of our end markets, with the seasonality of second half earnings consistent with what we saw in the pre-pandemic years.

Underlying demand remains good across the portfolio and a significant volume of business is already in the backlog. We proactively intervened on our cost structure starting in the latter half of 2022. And we have continued these structural cost reductions in 2023, driving material earnings benefits. As a result, we are less reliant on top line volume or price cost to achieve our forecast in the second half.

With our solid demand outlook, flexible business model and execution playbook, we are confident in delivering our second half target. We also see a solid foundation building for 2024. A large portion of our portfolio has experienced secular -- or cyclical momentum growth exposures that should persist in a variety of macro conditions and we are proactively adding capacity to ensure we continue to win in these markets.

We also expect solid carryover benefits into 2024 from previously announced cost reduction actions. These organic initiatives, together with a strong acquisition pipeline and meaningful cash flow generation will keep us on track to achieve our long-term growth and value creation goals we set forth in our Investor Day in March.

Let's go to Slide 4. Consolidated organic revenue was down 3% in the quarter despite growth in 3 of the 5 segments due to expected comparable volume declines in several end markets and the aforementioned shipment disruptions in vehicle market, which cost us 2% to the top line. Organic bookings were down 8%, resulting in a book-to-bill of 0.92, reflecting better lead times across the portfolio and continued strong shipments against backlogs in our longer cycle and secular growth exposed businesses.

As a result, our backlog continues to normalize, but still remains elevated relative to the pandemic levels. Segment margin was 20.2%, with margin performance preserved despite negative mix and lower volumes due to proactive cost containment actions and lower input costs. We expect the roll forward of these actions together with more normal demand seasonality to drive sequential and comparable operating margin improvement in the second half.

Let's skip to Slide 5, and we'll go through some detailed results on the quarter. Engineered Products was down 8% organically in the quarter. The waste handling business posted a particularly strong quarter, improving chassis availability and aftermarket attachment rates driving solid growth in volumes and new orders. We are presently taking capacity reservations for 2024 and we will be ramping production to meet demand progressively over the balance of the year.

Margins were down 50 basis points year-over-year, principally driven by lower volumes in vehicle aftermarket which offset the robust margin improvement in waste handling. Clean energy and fueling declined 9% on an organic basis as the final quarter of [EMV] comps impacted the top line and margin mix.

Vehicle wash and clean energy were down slightly in the quarter as distribution inventories were brought down in line with the increased cost to carry on higher interest rates. Channel checks indicate that we are now at appropriate levels for expected second half demand.

Margins in the quarter were down 100 basis points on lower volumes and mix, but partially offset by significant cost reduction actions taken in the retail fueling business as we pivot this business to margin and cash flow maximization. Imaging and ID was flat organically on solid growth in our core marketing coating business in Europe and the Americas as well as strong sales in software, serialization. Shipments in Asia were lower. FX remained a negative headwind to absolute revenue and profits in this segment given its large base of non-U.S. dollar revenue.

Margins in Imaging and ID was strong at 23% and improving 40 basis points on pricing and cost controls. Pumps and process was up 1% organically in the quarter, with particular strength in polymer processing equipment, precision components, thermal connectors and hygienic dosing systems. Volumes in industrial pumps was softer due to channel inventory reductions. Operating margin was down due to lower mix of biopharma.

Top line in climate and sustainability technologies were about 4% organically, demand trends remain robust in heat exchanges and CO2 refrigeration systems driven by global investments in sustainability. The segment posted a strong 7% margin in the quarter, up 210 basis points year-over-year on strong volume conversion productivity and positive price cost and mix of products delivered. I'll pass it to Brad from here.

Brad M. Cerepak - *Dover Corporation - Senior VP & CFO*

Thanks, Rich. Good morning, everyone. I'm now on Slide 7. The top bridge shows our organic revenue decline of 3%, driven by declines in Engineered Products and Clean Energy & Fueling. Acquisitions contributed 1% to the top line in the quarter, and FX translation was a 1% headwind.

FX headwinds resulted in $0.02 negative EPS impact in the quarter and $0.09 in the first half. Based on year-over-year exchange rates, we expect FX to be an $0.08 tailwind to EPS in the second half of the year. From a geo perspective, the U.S., our largest market, was down 9% in the quarter due to expected lower volumes in the aboveground retail fueling segment as well as lower shipments from vehicle services in North America.

Europe was down 1% and Asia was up 2%. China, which represent about half of our revenue base in Asia was up 5% organically in the quarter. On the bottom chart, bookings were down year-over-year due to normalizing lead times in our shorter-cycle businesses and strong shipments against elevated backlogs in our long cycle and secular growth exposed businesses.

Now on to Slide 8, our cash flow statement. Year-to-date, free cash flow came in at $348 million or 8% of revenue and represents an increase of nearly $250 million year-over-year. As discussed previously, with supply chains improving, we have been actively working to liquidate our working capital balances in 2023. We expect that trend to play out in the second half of the year as higher shipment volumes in the third and fourth quarter should result in a reduction of inventory balances between now and the end of the year. This trend is in line with our normal seasonal pattern, as cash flow generation has historically improved in the second half of the year.

Our forecast for free cash flow remains on track for between 15% and 17% of revenue. With that, I'm going to turn it back to Rich.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

All right. Let's go to Slide 9. Here, we show the growth in margin outlook by segment for 2023 that are underpinned in our current time log trends. Our backlog remains elevated across all segments driven primarily by extended backlogs in our longer cycle and secular growth exposed businesses as our lead times continue to normalize and new capacity comes online, we expect these backlogs to continue normalizing through the end of the year.

We expect Engineered products to return to growth in the second half of the year, driven by continued strength in refuse collection vehicles in aerospace and defense. Our waste handling business is fully booked for the year with the possible upside of chassis availability further improves. We expect vehicle aftermarket shipments in North America to recover after the temporary disruption in Q2 and the business should remain relatively stable year-over-year in the back half.

We expect margins to improve in the second half on positive price/cost tailwinds, solid volumes and benefits from our recent productivity capital investments taking hold. In Clean Energy & Fueling, it's expected to return to growth in the second half of the year against easier comparable periods as the end market conditions and channel inventories normalize.

Quoting activity for hydrogen infrastructure components remains robust, and we are working to expand capacity for select products, including vacuum jacketed piping in cryogenic valves. We expect full year margin improvement in Clean Energy & Fueling driven by stronger performance in the second half on volume recovery, improved mix and continued proactive restructuring savings in retail fueling.

Since initiating our fundamental transformation of the retail fueling cost structure last fall, we have initiated or announced $60 million of structural cost reductions in this business. Imaging and ID is expected to continue its stable performance, albeit against tougher comps in the second half, driven by stable outlook in core marketing and coding and serialization. Software full year margins should remain at attractive levels for this segment.

Pumps and process equipment is expected to remain roughly flat organically in the second half. Thermal connectors continued to grow at a double-digit clip with some notable customer wins. Following a record Q2 Precision Components continues to book and ship at robust levels and with a notable mix in business towards energy transition markets, polymer processing is booked for the year.

The biopharma environment is improving with market conditions such as FDA approvals for new promising therapies and recovery in biotech funding and inventory stocking all showing improvement as indicated by our customers who have released results over the past few days. We expect margins in this segment to remain best-in-class levels with performance skewed towards the end of the year on stronger volumes and mix improvements. Order rates and biopharma will be the watch item from here with the potential recovery -- with the potential for this recovery to be a material tailwind into 2024.

Climate and Sustainability Technologies top line trajectory is expected to be steady in the second half of the year. We are operating close to capacity in heat exchanges for heat pumps with incremental capacity coming online over the next several quarters with direct labor at less than 10% of revenue, the conversion on growth in heat exchanges is compelling.

Demand for CO2 refrigeration systems remain solid, and our capacity build-out is on schedule. We are starting to have productive conversations for our door case business with large retailers for their 2024 plans, which is an encouraging indicator of future demand. Beverage can-making is expected to be down as the industry is digesting recent record capacity additions.

We expect continued margin improvement in 2023 on volume conversion, productivity gains and improved mix. Our margin performance in refrigeration has been very encouraging even before the material accretive impact of North American CO2 volume.

Let's go to Slide 10. Here is the confidence we have in the underlying components that drive our forecasted double-digit EPS growth in the second half. We have been vocal about the negative impact of interest costs on channel inventories and have been encouraged that to draw down, while a headwind to the first half revenue has been orderly as end market demand is largely held up.

Recognizing that our markets are not immune to these dynamics, we have proactively enacted cost containment actions to derisk the second half of the year and also provide $40 million of incremental carryover cost savings into 2024 with roughly half the savings coming from retail fueling as part of our strategy to pivot to margin and cash flow maximization of this business. We believe our growth and conversion forecast is achieved based on our revenue visibility and backlog, channel inventory stabilization, secular growth tailwinds and recovery in end markets.

So let's go to Slide 11. We view 2023 as a transition year for our business from a supply chain constrained inflationary high-demand environment of 21 to 22 to a more normalized activity supported by various macro trends. As we move to the second half of the year, the majority of the destocking headwinds behind us and recovery across several end markets we are building solid momentum for 2024.

We are investing meaningfully behind our secular growth exposed end markets to ensure we have sufficient capacity to serve our customers. We are proactively engaging in new product development, often in co-development with our OEM partners to drive product improvement they win share in the marketplace. We believe our biopharma and retail fueling dispenser visits, which were in face with expected market-driven headwinds in 2023, are poised for strong margin accretive recoveries in 2024.

All in, we believe at least 40% of our portfolio is experiencing tailwinds that are decoupled from broader industrial production with additional pockets of growth in our market-leading niche industrial franchises. This growth outlook together, the carryover benefit of cost actions into '24, set up a solid foundation for our growth prospects in line with our financial commitments from our Investor Day in March.

So let's move to Slide 12. With our supply chains and operational environment normalizing our forecast for 2023 embedded in a return to pre-pandemic seasonality, the year has played out more or less as we expected thus far with more challenging half of the year now in the rearview mirror. The path from here is straightforward. Underlying demand is solid across our business, and we are confident in our ability to leverage a flexible operating model centralized business systems to drive consolidated growth and margin accretion to achieve our full year guidance.

Our inorganic pipeline remains robust. We remain committed to optimizing our business portfolio and evaluating some interesting options, which we hope to conclude in the second half of the year. That's it for me. I'll turn it back to you, Jack.

Jack Dickens

Shelby, you can go to the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Andrew Obin with Bank of America.

Andrew Burris Obin - *BofA Securities, Research Division - MD*

Just a question on sort of negative bookings, right, and revenue decline, generally, this destock takes more than 1 quarter, and I appreciate that you do have visibility, but I think versus our model, we were a bit surprised by the revenue. So what gives you confidence that this connection between bookings and destock that this is a 1-quarter event and does not sort of cascade into Q3?

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. I think you have to delink the comments we made about destocking from bookings to a certain extent. So I mean, the bookings number is related to the reduction in the backlog as the backlog slowly deflates and we expect that to continue some. So I wouldn't -- I think we've been pretty vocal about that all year. I think that what has changed in the first half of the year is the realization that the carrying cost of inventory in the channel has gone up exponentially, right?

So if you go take a look at the cost of financing inventory at a distribution level, gone up by 600 or 700 basis points. So I don't think it's unique when a company like Dover says moving into this year that we're going to run for cash and deplete our inventories. I think by and large, everybody was poised to do that. I think that what was underestimated was the short-term negative headwind on the cost to carry.

By doing the -- where we've seen that and where we've done channel checks, we believe that the vast majority of that reduction on the cost to carry is behind us. So we don't have that negative headwind going in the second half of the year, but I wouldn't get all caught up on the bookings side because the bookings are going to be reflective of the backlog decreasing, and I think that they're likely to inflect positive likely in Q4.

Andrew Burris Obin - *BofA Securities, Research Division - MD*

And just maybe looking and follow-up on pumps and process. Can we just go and be getting a lot of questions on that just by verticals, just a little bit more visibility on bookings and revenue visibility into the second half because it is a big focus for investors, particularly the timing of biopharma recovery.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. Well, I mean, I think that if you go back and read the transcript, I called out that the watch item from here is going to be bookings in biopharma, right? So we've taken a look what our customers are saying. And I think that if you go back and look at the timing, we've been suffering in lack of bookings there as our customers are prepared for the inevitable. Now they're beginning to call the bottom. And I think that we were early in terms of the reduction of inventory. So our expectation is that bookings inflect positive in the second half of the year on biopharma. It's just going to be a question of the quantum.

On the industrial pump side, I think that they suffered a little bit in terms of this channel destocking. Again, we think that that's bottomed now as a reference. And then -- the one that you have that really wags the tail here is going to be polymer processing, where at one point, we almost had two years of bookings in our backlog, and that's just been slowly deflating as we've shipped off that backlog. So I mean, there's moving parts between long cycle and short cycle. The biggest factors going forward from here is clearly going to be on the biopharma side because to the extent that, that inflects positive, I think that we're all cognizant about the margin impact that has on the segment.

Andrew Burris Obin - *BofA Securities, Research Division - MD*

Now this -- your comment on sort of cost of capital and inventories faster than anyone because the entire global supply chain has been floated at no interest rate is going to be fun to watch.

Operator

And we'll take our next question from Andy Kaplowitz with Citigroup.

Andrew Alec Kaplowitz - *Citigroup Inc., Research Division - MD and U.S. Industrial Sector Head*

Rich, maybe following up there. You've been, I guess, somewhat cautious on the macro, but you now have a whole slide on Dover strong foundation for '24. So maybe you could overlay your latest thinking on the macro versus that foundation. Would you say in the macro overall is holding up better or worse than you expected. And I know it's early. But given the backlog you have and the additional restructuring benefits for '24, I think you kind of mentioned that '24 could be in line with your sort of longer-term algorithm, which I think is 4% to 6% longer-term growth and 30% incrementals. Does it feel like there's a higher probability of that for '24?

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. I mean if you go back and read the transcript, I think I said that about 4x. We think that we knew we had some kind of secular headwinds between the biopharma side and the EMV roll off, we had that coming. That's part and parcel why I think that we were pretty transparent of what we were going to do to pivot our Fueling Solutions business.

And despite having the negative headwind on biopharma, we have preserved our margin in that business. So any incremental volume that we get there should be very attractive. In terms of the total macro, I guess we're happy that demand has held up, right? I mean I think you see part of the negative headwind to some of the destocking because everybody is destocking because they're afraid of the macro to a certain extent.

I think that's been exasperated a little bit by the cost of capital working its way through the system. Where we go from here? I guess we're positioning for a soft landing. Maybe that's optimistic and not generally in our nature around here. But we think the investments that we've made on our growth platforms, as I mentioned in the presentation, are growing at 20-plus percent.

And if we get some recovery on some of the secular headwinds we get, then you can easily go back to what we had laid out as our financial objectives. And you couple that with the fact that we've got a material amount of cost savings that roll from '23 into '24, that's a pretty good start in terms of margin.

Andrew Alec Kaplowitz - *Citigroup Inc., Research Division - MD and U.S. Industrial Sector Head*

Rich, that's helpful. And then maybe you can just talk about the puts and takes you're seeing in DCST. Maybe you could -- you talked about maybe some potential incremental weakness in [Belvac], but the rest of the business seems quite healthy. I think you had the debooking last quarter in door cases, where is that? Do you still expect that in the second half? And so just talk to us about puts and takes of the business because you said overall, it's pretty good.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Sure. Look, Belvac, it was great while it lasted. So we would expect that to -- it's a cyclical business, CapEx in this space is set to come down. I think that you've got to be careful about what your margin assumptions are in Belvac because we had a lot of engineering project work that was not just equipment-based. So the equipment we make some really healthy margins, but it was diluting. It basically boosted the revenue because we were more of a -- we moved to be more of an integrator. So I think that we can -- while the top line in Belvac was declined, I think that the margin preservation opportunity there is solid.

Right now, we're sold out in heat exchanges. If you go back again and look at the transcript here, the leverage on heat exchanges as -- it should be compelling. I mean, labor is 10% of our COGS. So think about it that way about what we need to cover there. Again, we're growing at 20%. I'll leave it up to the HVAC guys to talk about what the growth rates because we see them all over the place around heat pumps, but the fact of the matter is we're in the midst of increasing our capacity somewhere in the order of 40% to 50%, and it's all going to be in place by mid-2024. And so I think that will take care of any worries about what the cyclical decline in Belvac is.

On Refrigeration, we had our highest margin performance ever, at least in my tenure here in June. And that is even before we've ramped capacity at our new plant for CO2, which I think I'm going to go to on Thursday and Friday and see what we're here. We're probably not going to see the benefit of the NAFTA CO2 meaningfully. It's growing at like 80% right now, but it's off a really low base. But our expectation is, is that volume as it comes in is going to be accretive to margins in refrigeration.

So if I couple where we're exiting June in terms of core refrigeration, in terms of margin, and I add on what we expect to be a high-growth platform in CO2, which we've proven we can do in Europe. It looks good so far. So -- and as I mentioned in my comments, we're having at least the conversations right now around core for refrigeration with our clients about demand for 2024. So far, so good. It seems to be quite positive.

Operator

We'll take our next question from Joe Ritchie with Goldman Sachs.

Joseph Alfred Ritchie - *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

Can we just maybe just go back to the ERP issue. And Rich, maybe just talk us through a little bit what happened this quarter? And then it seems like it's largely behind you, but just want to make sure that there aren't any lingering effects in Q3.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. I've been doing ERP implementations for 30 years, and they never go right. This one went a little bit more wrong than usual. Look, at the end of the day, I mean, I own it, right? I mean we basically put a bunch of CapEx into our main plant in Madison, Indiana. That's not completely done. And at the same time, I think if you recall the presentation we made about this business, we had harmonized our SKUs meaningfully.

And quite frankly, in retrospect, trying to do an ERP when you're doing all that work on the manufacturing floor was misguided on my part. So that was just too much change to move to a new ERP system. At the same time, we have really trouble getting product out the door for the entire quarter, but it was worse at the beginning and we got progressively better as we exited June in terms of our production.

I don't think it's going to be a material headwind from here. I don't think we're completely out of the woods yet, but I don't think it's something that we'll be talking about earnings from here. I mean we do ERP implementations year-round year, and we've been doing them for years. Just I think it's my fault. I think I pushed one on a business that was too much to chew, but we're really excited about the opportunity that we have in e-commerce in this business, and you need a operated ERP to affect that e-commerce change and it kind of blew the plant up.

Brad M. Cerepak - *Dover Corporation - Senior VP & CFO*

Yes, I'd just echo what Rich said that we exited June at a pace that puts us on track for what we forecast for Q3. And as he said in the script, you can go back and look, we're going to try to recover, but we're not forecasting a recovery of that $50 million. So I think we're being prudent in terms of the way we think about the trajectory of that business in North America.

Joseph Alfred Ritchie - *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

Got it. No, that's helpful. And obviously, I always appreciate the transparency. My follow-up comment, I guess, would be just around like the [DPPS] business. So the margin profile of the business is trending a little bit lower than you originally expected for the year to kind of think about the second half kind of maybe talk to us about some puts and takes on the margin side, fully recognizing that biopharma is the swing factor.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. Biopharma is the swing factor. I think we've beaten that one pretty good. And you're going to take a look at what's Sartorius and Danaher and Thermo talk about it. They are much more informed in terms of when the pivot is going to be. I can tell you that. We're prepared in terms of at least operationally when the pivot comes, we're in good shape there.

It's a little bit -- I talked about the fact that industrial pumps was down because of some unexpected destocking. We think that that's sort of done. And then conversely, you've just got the mix effect of polymer processing and precision components did really well and have been doing really well all year, offsetting the negative headwinds in biopharma, but from a mix perspective, it just becomes dilutive to the margin. So weirdly, if they grow faster than expected, the actual consolidated margin comes down, but the absolute profit performance is entirely acceptable because even those 2 businesses are accretive to the consolidated portfolio margin.

Operator

We'll take our next question from Jeff Sprague with Vertical Research Partners.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder & Managing Partner*

Rich, can we just kind of talk about the margin progression a little bit sequentially. So I guess in EP, right, you have about a 200 bps hit on the ERP issue. Just kind of what the trajectory is out of Q2 as you normalize there? And then on DPPS, right, you said margins up in Q4 year-over-year. I guess that implies you're still down year-over-year in Q3. But would you expect sequential improvement in Q3? Or is the margin improvement in DPPS all kind of Q4 weighted?

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Okay. Yes, for DEP, you got it, right? So the margin decline in Q2 is solely on the fact on the VSG volumes coming out. As we move forward from here, you've got the capacity ramp and ESG that comes through, right? So that goose is the top line, and that's let's call that at par margin for DEP. You've got the recovery in VSG. And based on our backlog, we've got increased margin performance in defense just as we ship against the backlog. So that basically gives you the answer for second half margin performance there.

On DPPS, right now, our forecast show a negative headwind for Q3 solely on biopharma. And then our expectation, as I mentioned in the comments, depending on order rates and everything else, is that for Q4, we'll do better based on mix and some recovery on biopharma because it's not as if we're not shipping anything in biopharma. It's just the comparative headwind rolls off by the time we get to Q4.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder & Managing Partner*

Right. And then thinking about price cost, Rich, I assume that's sort of kind of buried in your growth conversion in the bridge. But what's going on with price cost in the back half of the year?

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

The price benefit is less in the back half of the year and the cost is based on where we're tracking right now. So we don't basically to make any assumptions in terms of other than leverage. We don't make any assumptions about either positive or negative on the input costs. We'll just see how that develops over the second half.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder & Managing Partner*

Maybe just one last one. I mean the questions I just asked about margins kind of get to Q3 versus Q4. But since we all kind of -- we got a Q2 that you're kind of characterizing is in line with what you expected ex the ERP, but we didn't quite totally get the message, right? So anything else you want to say about Q3 relative to Q4 or just the balance between those 2 would be helpful I think.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

I understand where you're going. All the stick I get about being negative all the time at these conferences and then apparently not negative enough in terms of segmenting the quarters. Look, I think that Q4 is going to be higher than expected. Q3 to Q3 is going to be more or less and in line. But I'd be careful at Q3, again, for the reason I mentioned, right? So you've got the negative biopharma in Q3, which is -- it's not so much a top line issue.

It's more of a margin contribution issue. And then we've got certain businesses that we expect to ship heavy in Q4, which is part and parcel to the end of the depletion of the inventory. So we're not getting into giving out quarterly guidance. I think I would be -- cautious isn't the wrong word. I just think that we're going to have a better Q4 than is likely in models currently.

Brad M. Cerepak - *Dover Corporation - Senior VP & CFO*

Yes. So it sequentially improves off of Q2 into Q3, but year-over-year, like Rich said, we're looking at a more comparable point on year-over-year. But again, we're expecting margin improvement for the full year for the total company. So therefore, in the fourth quarter.

Operator

And we'll take our next question from Steve Tusa with JPMorgan.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

A little bit to Jeff's question on, I guess, from a sales perspective, I guess what I'm struggling a little bit with is the sequential increase. I mean you got to be up sequentially half to half 9%. Got to do, I think, like roughly $4.5 billion, $4.6 billion in the second half and you're trending at 2.1. So I guess I'm just wondering, like, is that -- you're saying that's kind of all just out of backlog effectively. And so you don't need this bookings number to improve very much.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Well, I mean, like, yes, I don't think that we need the bookings to improve very much because you've got to be really careful about the long-cycle business. I mean, we do segments. And as you know, within the segments, we've got a mix of business. So we're going to have probably a pretty heavy depletion in backlog. Let's talk about DPPS of Maag, right? Maag sold out for the year.

So basically going to ship against that for the balance of the year. So it's going to make the bookings look a little bit negative. Now whether those get offset, we've got a lot of strength in bookings in Precision Components, and we would expect bookings to get better in biopharma, but we'll see whether that is a Q3 phenomenon or a Q4 phenomena.

I would back up for a moment and go take a look at the presentation we made and look at Slide 10 and take a look at what is required in terms of a conversion point of view. And if you take kind of mid 0.30% conversion and you're back into the number on the EPS accretion, that we need in the back half, it's not Herculean, right, because we almost have as much cost restructuring and cost actions is equal to what we need to get in terms of the revenue conversion.

So if we did not have that, I think there would be a little bit of a tough part in terms of the revenue required in the conversion. I think that all the work that we've done starting in the back half of last year has allowed us to be in the position of I don't know how the -- completely how the macro is going to develop. I mean these knuckleheads are going to go and raise interest rates again and that's not helpful. But the reason that we're confident about the back half is we've got almost -- we've got more than half of the required EPS conversion and cost savings that we've already enacted.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

Right. Did you expect -- did you expect bookings -- did you expect bookings to get worse from here sequentially? Or have we kind of bottomed on the bookings now?

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Hard to say. Hard to say. I mean you could have flat bookings in Q3. I mean there's an awareness in the marketplace that production lead times have come. So if our bookings, which are higher than normal, basically backstop our revenue for next year in the vast majority of our portfolio, you really don't need to start ordering until the beginning of Q4.

Now whether we can pull some of that in through market signaling, and that's when we start getting into what are we going to do about pricing in 2024, what are we going to go out to the marketplace and say about SWEP like weirdly, we're sold out in SWEP, but our bookings -- if you looked at our bookings in SWEP, you would think that we have no bookings for Q4 just because that's the dynamic of how that business works.

It's capacity reservation as opposed to bookings. So I wouldn't get excited about bookings. I can tell you factually, we'll ship off the back of Belvac and Maag, which will have a disproportionate negative impact on those 2 segments. The balance of the portfolio, I would presume in the short-cycle side, we're probably bottoming in bookings right now.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

All right. And then just one last one for you, Rich, just philosophically. I mean, the Slide 11 has like 9 different businesses, and that's only 40% of your portfolio. This has always been a bit of a complex portfolio, but the amount of things that you've had to walk through today, the amount of things that have happened in the last couple of quarters, whether it's the $90 million pushout, the ERP in somewhat obscure businesses, albeit pretty good businesses.

I think the only people that dislike having to dig into these little $100 million businesses, more than it sounds like you talk about them is us maybe. At what point do you kind of really take a much closer look at this portfolio and just kind of say it's just too complex to kind of run and manage, let alone invest in. I think that's kind of one of the issues here that people are having. Is there just always something moving around.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. No, I get it, and I will make -- I'll answer it 2 different ways. I think if you go back and look at the transcript, I talked about the portfolio and read what you'd like about that. And I'll make an argument that in 2024, the diversity of our portfolio will outperform certain secular themes that it's going to be an advantage in '24. It may not have been an advantage over the past 18 months just because of the disproportionate negative weight of biopharma, quite frankly. But I'm willing to bet in 2024, all the work we've done and the diversity of our portfolio would be an advantage as opposed to being kind of something that's singular in terms of market exposure that may be easy to understand.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

So can you grow double-digit EPS in '24? .

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Too early to tell. Too early to tell. I think it's going to be dependent on the macro, but I think that I can tell you that where we've invested, we're really excited about what we're getting out of it. And I think there are parts of our portfolio that have had negative headwinds. You can't really see it just because of the individual pieces that are really inflecting the other way. So I know that waste handling is not exciting, but the fact of the matter is that business could be up substantially in ['23].

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

All right. The gauntlets lay down. '24 is the year.

Operator

And we'll take our next question from Michael Halloran with Baird.

Michael Patrick Halloran - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

So the short cycle side of things, just some clarification here. I think basically what you're saying is the sell-out in the channel is actually pretty stable, pretty healthy sell-in because of the inventory destock side of things, that's where the headwind is and the expectations from here for that sellout piece to remain relatively stable. I mean that's a fair characterization.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. I mean I think that the end market demand has been okay across -- from the distribution side of the portfolio. But sell out, so the sell-out metrics look good. The channel checks that we're getting is basically our distributors saying the cost of capital on our inventory is just getting a bit much to bear here, and we're going to wait because, by the way, we know your lead times are down and we want the product, we can get it from. And look, I get it, right? Everybody is trying to maximize cash flow just because of the cost of carrying that cash flow, including us, by the way. So I don't think that distribution would be unique here. I think the good news is that the end market demand itself has remained pretty good overall.

Michael Patrick Halloran - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

Yes, makes sense. And then just on the imaging side of things, it sounds like things are a little bit more sluggish there, just some context and how much entirely just a little bit tightening on the consumer side or any other variables worth mentioning?

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes, it's the 1 -- well, 1 or 2 -- we have 2 businesses that have kind of a material exposure to China, and that's one of them. And that is just a reflection mostly of demand to China being quite poor.

Operator

We'll take our next question from Julian Mitchell with Barclays.

Julian C.H. Mitchell - *Barclays Bank PLC, Research Division - Research Analyst*

And I definitely listen to the exportation to check the transcript. But I wanted to put a finer point on a couple of things. One was just third quarter sales, Rich, are we assuming from what you said about shipping out of backlog in Q4 that sort of third quarter sales are flattish sequentially, and then you'll get this lift in the fourth quarter as the backlog depletes. And with your comments on bookings to be sort of flattish Q3 and then in flex maybe Q4. Were those sort of sequential comments as well? I just wanted to check that, please.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. Julian, I don't want to be overtly negative about Q3, all right? So Q3 is going to get sequentially better. It's just that proportionally based on where we can see the orders and when they're due to ship that sequentially, Q4 is going to be better than it's been over the last I don't want to go back to 2020, I don't remember, but it's going to go back to the way we looked pre-pandemic, where we shipped pretty heavily in Q4.

And then it just becomes a question of production performance in Q4 and that is going to be dependent on what the order rates look like between Q3 and Q4? And do we have to start building out in Q4 for volume for '24. Now there's going to be some businesses where that's the case. So the businesses that were sold out this year, which is several portions of the portfolio, we're going to start taking orders for '24 relatively soon. We're taking orders and right now in certain parts of the portfolio for that.

So I don't want to be overly negative on Q3. I think the Q3 is going to be a good quarter. But I think the Q4, at least comparably is going to be a better quarter. I think that in terms of the order rates -- it's more of a we'll see. We know we're going to ship off backlog in Q3 pretty heavily. So they may be book-to-bill maybe less than 1. It may not be. And our expectation is that Q4 should be up at least almost by definition comparably.

Julian C.H. Mitchell - *Barclays Bank PLC, Research Division - Research Analyst*

That's very helpful. And then trying to switch away from bookings and backlog and so on maybe just capital deployment that there hasn't been that much on. You'd mentioned sort of watch this space, I think, on M&A in the coming months. It's been a pretty more abundant M&A environment for 18-plus months. So kind of how do you see that? And then also with the stock where it is, a lot of people view the valuation is undemanding. Kind of what's the appeal on share buybacks given the sort of solid outlook for 2024 that you've talked about? .

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Yes. Our hierarchy remains the same. I think we haven't added anything in terms of our CapEx plans because we've actually had good 3, 4 years of a lot of spending in terms of recapitalizing some portions of our portfolio, and that's in our rearview mirror now. So by and large, our CapEx as a percentage of sales it's coming down this year, and it should continue that trajectory, even if I take into account the CapEx that we're building out on our growth platforms.

So that leaves M&A as the second hierarchy. Competition is less than there's not a lot of assets out there, but competition is less. So PE is a bit stopped out right now for the reasons we can understand. So that -- we're looking at some attractive things here, but we're going to keep our discipline in terms of the return. And clearly, if you remember from last year, we get to the midyear, we basically forecast our cash flow as we take a look at our deal pipeline. And if you remember last year, we deployed -- how much was it $0.5 billion?

Brad M. Cerepak - *Dover Corporation - Senior VP & CFO*

$0.5 billion

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

$0.5 billion in an ASR in September of last year. So we've got a Board meeting coming up, and we'll go through all those dynamics again, and we'll decide what to do.

Operator

And we'll take our next question from Deane Dray with RBC Capital Markets.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

Sorry to beat on this ERP and I will check the transcript in case I missed it. But just, Brad, you said you're not including a recouping of the $50 million that was disrupted this quarter. Does that go into past due? Or did you lose any of those orders?

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

You lose the order Deane. A lot of that is sold into distribution and that the product is available, you would lose out of the order. So we'll recoup some of it, but I think that we will not recruit all of it. .

Brad M. Cerepak - *Dover Corporation - Senior VP & CFO*

Yes. My commentary was more around our view is the back half is not dependent upon recovery of the $50 million. I want to be clear, that's the point really at the end of the day. The team there will try their best. But it is a business that, as Rich says, our customer base stocks these things in distribution and they move out. And if it's not there, they go to the next available competitive unit. So that's the way we see it.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

All right. That's really helpful. And then, Brad, in the second half inventory draw down, how much of that is coming just simply from billing orders versus reducing buffer inventory. Are you able to size that?

Brad M. Cerepak - *Dover Corporation - Senior VP & CFO*

Not explicitly, but I think the way we're working through it is that -- it's mainly driven by, I would say, more towards -- tilted towards the safety stock levels, the buffer inventory and raw materials in the materials flow where what we have to see is less inflow versus production to draw it down. And that's what's happening here in the second quarter. I mean, we did have slightly negative inventory through the first half of the year. But it's a heck of a lot better than it was a year ago, and we're continuing to make progress to make sure production is in excess of the inflows. That's the way we're working it. I think that's it, Jack. Okay.

Operator

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

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Are you sure? Do you want to finish it off or should I ask the question?

Brad M. Cerepak - *Dover Corporation - Senior VP & CFO*

Go ahead. We didn't want to cut you off.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Yes, don't worry. I'm kidding. Look, so look, we love your macro perspective. You were very early to be cautious and what you so. But it seems like some of the CapEx businesses may be trending a bit weaker. Belvac, Hill PHOENIX. Maybe just some perspective on what you're seeing in those capital businesses. And is it an adjustment to higher rates? Macro uncertainty, what do you think -- how do you think this plays out?

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

Well, I mean, I think the Belvac is a cyclical business. There was a lot of capital that was put in during the pandemic years into can-making. We did fabulous in terms of market participation there versus our competitors, but we fully expect and have been preparing for over the last 18 months were there be some roll down because you just can't keep at that kind of pace. Now having said that, I don't think it's a negative of a story either just because of the fact that the revenue was a bit influenced by some engineering work that we did at very low margins and while we sold the equipment.

And we're actually working on some interesting IP related projects that may help us out to ride the CapEx. On the Refrigeration side, we had that order cancellation that we talked about at the end of last quarter. That was very customer specific. The balance of the demand is decent. I think that there's a little bit of the same frictional costs in terms of labor availability and installation. That's not our problem. It's our customers' problem. The pace of that CapEx tends to be a bit choppy, but the conversations that we're having, and I think it's in the -- in the transcript, the conversations we're having about 2024 in terms of demand in that particular space are good. And I'm just talking about kind of the old traditional case business. Without even getting into natural refrigerants where we're growing at a very heady pace in North America right now off a low base. But based on the conversations that we're having this we feel very excited about where this thing could go.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Okay. That's helpful. A quick follow-on, if I can. Retail fielding, you mentioned focusing on [Martin and catalog] and obviously, the restructuring actions that speak to that. You've talked about this before, but is this like a double and down of that strategy? Does this become even more of a focus on just cash flow as opposed to growth.

Richard Joseph Tobin - *Dover Corporation - President, CEO & Director*

No. I mean I think we have individual strategies for every business that we have in the portfolio. Obviously, if you go back a couple of years ago, this was EVs are taking over the world and the negative headwinds of EMV plus that the view of what these businesses were worth was, I think, a completely overdone. We think that we've got 20 years of high-margin opportunity into that space. But having said that, we're just repositioning that business where we think that we've upgraded the entire product line globally, by the way, not just in the United States, that we can run that. We can run this business a lot more or a lot more lean than we did in the past, and that's the actions you see us taking. We think we can get that segment to 25%. And you're seeing some of the building blocks working our way there.

Operator

That concludes our question-and-answer period and Dover's Second Quarter 2023 Earnings Conference Call. You may now disconnect your lines at this time, and have a wonderful day.