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DOV.N - Q4 2020 Dover Corp Earnings Call

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OVERVIEW:

Co. reported 4Q20 revenue of $1.8b. Expects 2021 organic revenue growth to be 5-6% and adjusted EPS to be $6.25-6.45.

REFINITIV

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PRESENTATION

Operator

Good morning, and welcome to Dover's Fourth Quarter and Fiscal Year Ending 2020 Earnings Conference Call. Speakers today are Richard J. Tobin, President and Chief Executive Officer; Brad Cerepak, Senior Vice President and Chief Financial Officer; and Andrey Galiuk, Vice President of Corporate Development and Investor Relations.

(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. Andrey Galiuk. Please go ahead, sir.

Andrey Galiuk - *Dover Corporation - VP of Corporate Development & IR*

Thank you, Nicole. Good morning, everyone, and thank you for joining our call. This call will be available for playback through February 18, and the audio portion of this call will be archived on our website for 3 months. Dover provides non-GAAP information and reconciliations between GAAP and adjusted measures and are included in our investor supplement and presentation materials, which are available on our website.

We want to remind everyone that our comments today may contain forward-looking statements that are subject to uncertainties and risks, including the impact of COVID-19 on the global economy and our customers, suppliers, employees, operations, business, liquidity and cash flow. We caution everyone to be guided in their analysis of Dover by referring to our Form 10-K and Form 10-Q for the first -- for the quarter and for a list of factors that could cause our results to differ from those anticipated in any forward-looking statement. We undertake no obligation to publicly update or revise any forward-looking statements, except as required by law.

And with that, I will turn this call over to Rich.

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

Thanks, Andrey. Good morning, everyone. Let's begin on Slide 3. Order trends have remained positive across the majority of our portfolio since September, and we had a strong finish to the year. Our year-over-year backlog is up 21% as a result of general recovery trends across the portfolio, a meaningful increase in the DRFE segment backlog and some recognition from our customers that raw material costs and supply chain constraints are becoming more challenging into 2021, driving preorders in some markets.

Revenue at $1.8 billion was flat versus the comparable period. Adjusted segment operating margin at 17.1% was flat despite unfavorable revenue mix during the quarter. For the full year, revenue was down 6% and adjusted segment margin up to 16.7% as a result of structural cost savings, center-led strategic initiatives, tight cost controls offsetting the impact of fixed costs under absorption.

As we discussed at length in Q3, we are driving towards a strong cash flow performance in the fourth quarter, and we got it, with full year free cash flow increasing 24% over 2019, achieving 14% of revenue. This is what we would expect to happen as we liquidate working capital in excess of lost profits impact, and as a result of efficiency gains from our back office consolidation program.

With that backdrop, we look into 2021 with conservative optimism. Our order book is solid, albeit with a different mix as compared to last year, with DRFE having a material positive impact to the top and bottom line in '21. We are executing on many initiatives other than structural cost takeout that are expected to deliver margin improvements, which I'll cover later in the presentation.

With that, we are initiating full year guidance of 5% to 6% organic revenue growth and adjusted EPS of $6.25 to $6.45. I'll not spend a lot of time on Slide 4, which is a more detailed overview of the results of the quarter. So let's move to Slide 5.

Engineered Products revenue declined on lower shipments in CapEx levered markets such as industrial winches, waste handling equipment and vehicle services. ESG had a tough Q4 comparable to overcome and VSG was coming off a strong Q3, so the performance was largely expected, both have strong backlogs into 2021. The Aerospace & Defense business had a strong quarter that ended a record year for the business, and demand in industrial automation has shown robust recovery contributing to our backlog as global auto sequentially ramps production.

In Fueling Solutions, as we discussed at the end of Q3, the comparable benchmark for Q4 was tough. Despite the top line pressure, the segment posted another quarter of strong margin performance on lower volume as our as our productivity actions remain durable.

We are beginning to see the mix benefits from our Helix and Anthem dispenser products, which we believe are winning in the marketplace. We completed the acquisition of Innovation Control Systems in the fourth quarter, which is a great addition to our vehicle launch platform. ICS is a leading supplier of access, payment and site management solutions and software, which fits into our strategy of driving long-term value from the large installed base of retail fuel sites, which we presented in October.

Sales in Imaging & Identification declined 3% organically. The core Marking & Coding business grew on continued healthy demand for consumables and improvement in demand for principal equipment, with particularly healthy activity in the United States. Digital textile printing CapEx remains slow, but we will begin seeing recovery in demand for consumables and small format machines, which are likely harbingers of conditions normalizing in 2021.

Imaging & Identification is our highest gross margin segment. The Marking & Coding business has delivered commendable margin performance this year holding the profit line virtually unchanged. However, decrementals in textile printing on lower volumes weighed on the segment margins in Q4 and during the full year. We expect this to begin reversing progressively into 2021.

Pumps & Process Solutions returned to top line in the fourth quarter on strong growth in biopharma, medical and hygienic applications. We also began seeing cyclical recovery in industrial pumps which posted growth after several soft quarters. Compression components in aftermarket continued to be slow, but recent trends in natural gas and LNG markets gives us grounds for optimism going forward.

The fourth quarter closed off a solid margin performance in this segment, with margins expanding 150 basis points in Q4 and 220 basis points for the full year. This was driven by broad-based productivity efforts, cost controls, favorable mix and well-timed capacity expansion in biopharma and medical, which we highlighted earlier in the year.

Refrigeration & Food Equipment posted 13% organic growth, with all businesses except Food Service Equipment delivering the increase. A significant portion of the growth came from the well advertised strength in can making. We are also very encouraged by activity in core food retail market, which grew organic top line at high single digits in the quarter, driven by the continued strength in the door case product line, where we saw double-digit growth for the full year. The heat exchanger business grew on robust demand in heat pumps and residential applications as well as refrigerated, transport and industrial applications like semiconductors and data centers.

Margin performance effectively improved, supported by volume and actions we took in the middle of 2020. Absolute earnings increased 71% in the quarter over the comparable period. This margin performance, coupled with the upcoming ramp-up of automated case line and food retail, positions us to deliver material margin expansion in 2021.

I'll pass it to Brad here.

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

Thanks, Rich. Good morning, everyone. Let's go to Slide 6. On the top is the revenue bridge. Our top line continued its recovery, with sequential improvement in organic revenue over Q3. Several of our businesses, including short-cycle industrial pumps and heat exchanges, returned to positive growth in the quarter, while biopharma, aerospace and defense, marking & coding, food retail and can making continued their positive growth trajectory from prior quarters.

FX benefited the top line by 2% or $34 million, driven principally by a strengthening of the euro against the dollar. Acquisitions more than offset dispositions in the quarter by $12 million. We expect this number to grow in subsequent quarters. The revenue breakdown by geography reflects sequential improvement in each major geography, except -- with the exception of Asia.

The U.S., our largest market, posted a 1% organic decline in the quarter, an improvement over the 4% decline in Q3 on progressively improving order rates and a strong quarter in biopharma, marking & coding, food retail and can making, among others. Europe declined 3% organically, driven by retail fueling and a difficult comparable quarter in vehicle services, though partially offset by continued strength in several of our Pumps & Process Solutions businesses.

All of Asia was down 11% organically, driven principally by China, which was down 16% organically. This result in China was not unexpected as we continue to face headwinds in retail fueling due to the expiration of the underground equipment replacement mandate.

Moving to the bottom of the page. Bookings were up 2% organically, reflecting the continued momentum we see across our businesses. In the quarter, we saw organic growth in 4 out of our 5 segments. The fifth segment, Fueling Solutions, faced a difficult comparable quarter in the prior year, as previously discussed. Overall, our backlog is currently up approximately $300 million or 21% higher compared to this time last year, positioning us well as we enter 2021.

Let's go to the earnings bridges on Slide 7. We delivered improved sequential results in the quarter after a significant decline in Q2 and a recovery in Q3. On the top chart, adjusted segment EBIT and margin were both essentially flat year-over-year as we -- as continued productivity initiatives offset negative organic growth and dilutive impact of FX on margins.

Going to the bottom chart, adjusted net earnings declined $1 million as higher taxes and corporate expense offset improved segment EBIT. The effective tax rate, excluding discrete tax benefits, was approximately 21.4% for the year compared to 21.5% in the prior year. Discrete tax benefits were $8 million in the quarter and $22 million for the year, or approximately $4 million lower than in 2019.

As we move into 2021, excluding the impact of discrete taxes, we expect the effective tax rate to remain essentially the same as 2020 at about 21.5%. Rightsizing and other costs were $21 million in the quarter, or $17 million after tax, relating to several new permanent cost containment initiatives and other items that we executed at the end of 2020.

Now on Slide 8. We are pleased with the cash performance in 2020, with full year free cash flow of $939 million, a $181 million or 24% increase over last year. Free cash flow conversion stands at 21% of revenue for the fourth quarter, historically our highest cash flow quarter, and 14% for the full year, a significant increase over the prior year. The call of last quarter's earnings call, we decided to prioritize prudent working capital management over fixed cost absorption to close out the year, and you can see the value delivered in our year-over-year working capital comparison. We have strong revenue visibility into Q1 and confidence in our team's ability to match industrial production with improved customer demand.

With that, I'll turn it back to Rich.

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

Okay. Thanks, Brad. I'm on Page 9. Let me take a few moments to give you an update on our center-led initiatives that we outlined in our strategic plan in September of 2019. While we could have not expected but transpired in 2020, we posited at the time that our portfolio had through-cycle durability and that there were opportunities to drive synergies from our diverse portfolio to improve profitability over time. Despite this, we often hear a notion that Dover is a cost-out story, likely because we give measurable, structural cost saving goals each year, implying a finite nature to such endeavor.

There's a lot more than cost reductions to our improvement journey, and we continue to reinvest a portion of the savings, so we'll give you a short update on where we are on these strategic initiatives.

True in 2019, we began with the rightsizing of our SG&A base after a significant portfolio change. This was necessary and required immediate intervention. Since then, the improvements have been driven by steady productivity and structural cost actions by our operating units, and from our investments in 4 core enterprise capabilities that generate very attractive return on investment and can be leveraged across the portfolio. The investments are substantial. By the end of this coming year, the headcount involved at center-led enterprise capabilities will have increased by over 50%. These are transformational initiatives touching every corner of our global portfolio and delivering real results that you can see in our bottom line, and there is significant runway to drive value. We are investing in the following 4 enterprise capabilities, and I'll highlight a few results, but I would encourage you to review the stats in the slides.

First, Dover Digital on Slide 10. This work began in 2017 and accelerated in 2018 with the opening of our Dover Digital Center in Boston. We have over 100 e-commerce connected product and software experts dedicated to this event. This team helps our business lever each commerce at scale and improve the customer journey with ease of doing business as well as back-end efficiency for sales and order entry. For example, this year, we target to reach a run rate of $1 billion of revenue processed through digital channels, much of which is service parts and catalog items compared to $100 million in 2019. This team also helps a business connect their products and enhance their offerings, which we'll progressively highlight in future presentations as we did for Fueling Solutions recently. This is a multiyear journey, value creation journey, and we are very excited about what lies ahead for our digital team.

Moving to Slide 11. Our Operations Center of Excellence is a central team of domain knowledge experts that delivers health and safety, supply chain management, lean operations and advanced manufacturing and automation. This team is instrumental in driving value through rooftop consolidation and automation projects. As you know, we have a number of these in the works. We are also excited about the results of the early lean initiatives this team is spearheading. This is another multiyear journey that we continue -- we will continue to deliver results.

Moving on to Slide 12 is our central back office system, which we call Dover Business Services. We've been at this for several years, and we're still in the early innings of expanding the scale and scope of this capability. By centralizing and offshoring transactional back-office facilities, we multiply efficiency through scale, technology leverage and unit cost arbitrage. DBS is and will remain an integral part of our margin enhancement story.

And lastly, moving to Slide 13, the India innovation center is more than 600-person strong team that our operating companies can leverage for product engineering, digital solutions development, data information management, research and development and intellectual property services. The scale and expertise of this team allows our operating companies to tap resources that would have been unaffordable to them as stand-alone companies and allows for concurrent engineering on time-sensitive projects.

So let's sum this up on Slide 14. We laid out 4 pillars of our strategy in 2019, and have been delivering through cycle. We have maintained our focus on margin improvement and continue to invest despite the economic difficulties of 2020. Our end market exposures, coupled with the strategic R&D investments, are delivering attractive growth profile. We are committed to reinvesting in our businesses as a top priority and capital allocation to maintain competitiveness, fuel growth and improve productivity. We are making good strides on the inorganic front. Finally, we're staying disciplined in our capital allocation by returning excess capital to our shareholders while growing dividends and share repurchases.

Moving to 15, where does this leave us going into 2021? We believe that our playbook offers us a significant runway to continue delivering attractive through-cycle returns through mid-single-digit top line growth, steady margin expansion, healthy cash conversion and disciplined capital allocation and shareholder-friendly capital return posture.

Okay. I'll step off the soapbox, and let's move on to 16. We expect demand in engineered products to rebound in 2021. We have seen strong bookings recently in vehicle services and industrial automation, with relevant automotive and vehicle usage statistics trending in the right direction. Bookings have also improved to retain in waste handling, and we are nearly fully booked for the first quarter. Municipal demand will remain uncertain, but we see strong trends in the parts and digital business.

As we previewed in November, we expect Fueling Solutions to have a modest organic growth year. There is known headwind from EMV roll off in the U.S., but there are a number of positives also. We are encouraged by the prospects of our new Anthem user interface solution offering. We expect robust growth in our systems and software business, where we will be launching the industry-first cloud platform developed with Microsoft. We also see good setup for vehicle wash and are excited about having ICS in our portfolio.

We expect Imaging & Identification to perform well this year. Marking & Coding saw a limited downside in 2020, and we've been on a good trajectory in recent quarters despite the tough comp in Q1 due to COVID-driven consumable stocking. We expect further improvement in services as travel restriction subside and activity in serialization software is also firming up. The biggest factor in this segment is, of course, the digital textile printing unit. Our initial read is for the recovery to take place in the second half of the year when printers will be ramping up production for 2020 apparel collections.

Pumps & Process Solutions is expected to have another solid year. We expect a robust growth in biopharma and hygienic applications and a continued recovery trend in industrial pumps. Plastics and polymers is expected to deliver steady performance with a comparable basis to the second half -- biased to the second half. Precision components is likely to experience a slower start to the year, and we're still comping versus last year's first quarter that saw robust upstream and downstream activity.

And finally, we expect a very strong year in Refrigeration & Food Equipment. The core food retail business is operating with a strong backlog and the order trajectory has been healthy in the last few quarters. We expect retailers that have paused their remodel programs last year amidst the pandemic to restart these strategic initiatives, and we are well positioned to participate in that activity. Additionally, we see a good outlook for natural refrigerant systems, both in Europe and also in the U.S., where California was the first state to recently mandate transition to natural refrigerant systems.

We were the pioneers in the space, and we are very well positioned to capitalize on the sustainability trend in the industry. Belvac, as you know, is working through a record backlog and is booked for the year. Our heat exchanger business also exited 2020 with a record backlog and a constructive order trajectory across multiple verticals. This will result in material margin improvement in this segment on the back of the case production automation project, higher volumes, positive business mix.

We've covered most of the items on the earlier slides, but I'll summarize them here on this slide for your reference. As usual, before I wrap up, I'd like to thank everyone at Dover for their work and continued perseverance during this last year. The Dover team has delivered strong results in its difficult conditions, and I commend all of our employees for doing that part.

And Andrey, with that, let's move on to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from the line of Jeffrey Sprague with Vertical Research.

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

A lot of good additional information there. But just let me dig into like a couple of things, if I could, Rich. First, interesting what you said about kind of preordering. Are you able to fully protect yourself with price and hedging and other things on that type of activity that you're seeing from your customers?

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

Yes. Look, Jeff, I mean, I think we've got a couple of challenges going into Q1. Raw material prices are moving up. And there is a lot of constraint in logistics right now. I think that it's been going on somewhat through the fourth quarter. And it looks to be getting tighter going into the first quarter as economic activity moves up. So the bad news is, we're going to have to deal with those constraints, and we're going to have to be on the front foot in terms of offsetting the raw materials in terms of whether it's either pricing or productivity.

But I think that my comment about the backlog, it is influencing demand in the backlog because, I think, that there's beginning a recognition out there of, "I've got to get my orders in because of these constraints." I mean, it's -- look at what's going on in auto, just as a precursor to that. So I don't think it's bad in a way, and I don't think it's negative for us in terms of people placing orders in advance of raw material costs because, I think, that we've got some levers to pull there, and it's really short-cycle at the end of the day. The good news is, I think, to the extent that our backlogs go up from an S&OP process, so we can plan more appropriately, and that drives efficiency at the factory level floor. So probably going to be a little bit of an interest in Q1, but I think, overall, it's not insurmountable.

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

Right. And then just shifting to the DRFE. So it looks like you'll have the volumes here to fully kind of exercise the automation project. I suppose you don't want to get into margins by segments here. But can you give us a little color on how the margin should play out in that business? And is there any kind of -- other than kind of the normal seasonal peak that we'll be looking at, any other kind of noise or movement in the margin trajectory there?

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

No. I would expect that the margins to comp well every quarter, but the seasonality of those margins to remain intact.

Operator

The next question comes from the line of Steve Tusa with JPMorgan.

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

I think with the lots of buzzwords, Rich, not used to you kind of like talking at that high of a level about corporate strategy. But I think the message is that there's something like a little bit more sustainable than just like a couple of years of cost cuts. And noticeable to me was the 25% to 35% incremental margin guide. And then the 11% to 13% of revenue in free cash flow in a year where I'll be growing pretty strongly. So basically, you should see some headwind. It shouldn't be like a gray cash year, for example. I think, back in 2019, in the fall, you said 25% to 30% incrementals and 8% to 12% free cash as a percentage of sales. Are these kind of like sustainable step-ups that you'd hope to deliver over time as part of the earnings and cash algorithm?

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

Yes. Look, at the end of the day, we expect to be pulling on both levers, consistent margin expansion and cash flow productivity. So productivity and the working capital item. Bottom line is, as we've been saying all year, we would expect with the headwinds that we'd be liquidating our balance sheet, as we should, in a difficult environment on the revenue side. We will have a working capital build because we've got a pretty robust revenue forecast going into '21. But do I think it's going to make our metrics worse? Not demonstrably so because I think that we're going to get the benefit of the margin expansion. And I don't expect to deteriorate at all in terms of working capital as a percent of sales.

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

And I would guess -- I mean, when I look at that 11% to 13% of revenues, I mean, it's not like your CapEx is actually above what I would expect it to be. I mean, is the $175 million to $200 million now a sustainable run rate? Or is that something that you push some projects out of '20 into '21? Because I think you guys are planning on that coming down a bit that there were some temporary projects. What's the outlook for CapEx for the next couple of years?

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

Yes. I mean, we've got 2 new transformational projects underway, one in vehicle services group, and one in ESG, which -- look, at the end of the day, they're not nearly the same scale of the new building that we did at CPC, and what we did at DFR, but it's the same logic. I mean, it's automating what we're pretty manual processes. So I think that we're going to get a relatively quick payback in terms of the margin expansion there. It's early in the year. I think that we've tended to always forecast a higher CapEx number that actually gets delivered. That number looks reasonable considering we've got 2 bigger projects. But -- so I don't want to take the number down right now or say it's an anomaly, but experience would say that it's probably a little bit high.

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

Right. But I mean, if you do 11% to 13% of revenue, even with that, it's not that bad. Just 1 quick one. You guys had talked about, I think, $25 million of temporary cost reversals as a headwind in '21. Can you just give us an update on that number, if there's anything that's coming back relative to what you did last year to protect the margins?

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

There's nothing. Look, at the end of the day, we'll be building. We've got estimates of building it back, some incentive comp and a variety of other things. But look, it's all built into the EPS forecast that we have there. Whatever the pullback of kind of -- let me split -- let me answer you this way, right? We had coverage on furloughs, okay? So that was a positive this year because it deferred the cost of us having to take those people out to a certain extent.

What we're going to bring back is going to be absorbed into industrial production in the revenue line. So net-net, that's an indifference. So what we're talking about is general SG&A, And the bigger movements there were T&E and incentive comps. So let's think positive for a moment, the incentive comp comes back, I think, T&E is going to come back. But is it going to reach 2019 levels? No.

Operator

Our next question comes from the line of Andrew Kaplowitz with City Group.

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

Rich, with the understanding that we don't want to get too far ahead of ourselves in R&FE with the backlog that you have in the core food retail business picking up as well as the Belvac deliveries ramping up, would you actually say that high single-digit forecast for '21 could even be conservative, given the double-digit momentum you saw in Q4?

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

It's a little bit early to...

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

I said we don't want to get ahead of ourselves.

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

Yes, let's get ahead of ourselves while we're not getting ahead ourselves. Look, you know what, I think that the backlog is a good precursor for delivering the incremental margins that we're looking for from a segment point of view. Our expectation, it's the highest growth segment in our forecast right now. And I'd have to go back to look because it's a margin differential, but it's a material contributor to the EPS expansion. So to the extent the trend continues because this is a relatively short-cycle business, if I -- just talking about refrigeration now, not Belvac. Belvac is booked for the year.

So if we get more orders for callback, it just gets pushed into 2022 quite frankly. So DFR, which is generally a short-cycle business, we're covered for Q1 and beginning to get coverage into Q2. Let's get Q1 under our belt before we start moving the number up.

But it's -- a lot of the total profit change that we have baked into the EPS is coming from that segment. By the way, and the reason one -- you could say, well, it's not overly aggressive in terms of the conversion rate, remember, that's one of our lower-margin businesses, so that's going to bring down the consolidated conversion a little bit. But we'll take it in terms of absolute profits.

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

Very helpful. And then, Rich, just in Engineered Products, maybe just give us a little more color into what happened in the quarter in Q4? I know you said it was just basically expected sales decline. Did you see any inflationary pressure in that segment in the quarter? And how are you thinking about the margin in that segment in '21?

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

It's not inflation. I mean, I think that if you go back in Q3, we -- the guys did a fantastic job in VSG of delivering off a backlog that had built during the quarter. So the production performance there was very, very good. And it actually aide into Q4 from a comparable point of view. So that's not a problem there. And ESG, I mean the weak part of the market, which we've been talking about all year is municipal. And generally speaking, municipal tends to get delivered at the end of the year, so we know that they had a bad comp.

Having said that, look, at the end of the day, those are -- that segment is more of our industrial businesses. So that's where the raw material headwinds are. And look, we're going to have to work that out between volume price and productivity. But I think, we fully expect, portfolio-wide, to offset all raw material headwinds.

Operator

The next question comes from the line of John Inch with Gordon Haskett.

John George Inch - *Gordon Haskett Research Advisors - MD & Senior Analyst of Multi-Industrials*

If the economy were to, Rich, really pick up starting, say, in the second half as let's presume vaccine rollout is successful, are you geared to handle what could be a material upsurge in demand? Or would you have to like -- would you have to kind of come up with a plan to sort of debottleneck or expand capacity or bring a bunch of people back. Like how would that work?

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

The only area that we've got real capacity constraint would be in a niche business like Belvac. The balance of the portfolio does not run on even 5-day, 3-shift operations, quite frankly, for the middle part, we're a 6-day a week single shift group here. So to the extent that we have some amount of visibility, and to the extent that as economic activity ramps that the supply chain keeps up with it, which it isn't right now, I don't think that we are capacity constrained in any meaningful thing.

Having said that, I mean, in terms of top line growth, I think that we are expecting economic activity to kind of sequentially ramp through '21 even in our forecast. But are we capacity constrained outside of some of our nicher businesses? No.

John George Inch - *Gordon Haskett Research Advisors - MD & Senior Analyst of Multi-Industrials*

No, that's fair. You just mentioned supply chain, by the way. Are you at a point where you're trying to circumvent this? Or are you letting it ride to see how it happens? Meaning, I don't know, possibly seek other suppliers, dual sourcing, that sort of thing? Or is it still sort of too early to tell?

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

No, no, no. We're doing everything under our power to get beyond this because whether that is buying raw materials forward because into the increasing curve on plate steel or sheet metal or something like that, which we're doing. We've been giving guidance to all of our operating companies that, from a working capital perspective, if they need to build at the beginning of the year and bleed it off in the second half of the year, we take the production performance and the efficiency of that rather than getting it to stop/start kind of scenario. And then there are certain -- a lot of the pinch points forget kind of logistics with container freight and everything else, some of the pinch points on electronic components, we're fighting it out with everybody else.

John George Inch - *Gordon Haskett Research Advisors - MD & Senior Analyst of Multi-Industrials*

Okay. No, that makes sense. Maybe just lastly here. I'm actually really intrigued by the attention you put toward India business services and so forth and deservedly so. If Dover were a substantially larger company, would efficiencies in the initiatives like the Dover Business Services exponentially compound? I mean, you're not a huge company, right? So if you were, all of a sudden, to do M&A and become a lot larger, would sort of those benefits accrue as a compounded basis or prospectively at a linear basis? It's almost like can these things that you're creating serve to create for mechanisms to justify why Dover should actually continue to expand into adjacencies to create shareholder value.

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

Well, look, the reason that we're doing it is, as we said all along that Dover's reason to exist is to bring services at scale that are kind of our smaller companies would not be able to do on their own.

Having said that, as we build those services, we're not even beginning to scratch the surface of the leverage that we get because the fact of the matter is, despite the robust trend and growth that we have, we're continuing to reinvest. At a certain point, you've built enough scale that bringing on another 100,000 transactions doesn't require you to build out anything more. So you flip over in terms of the benefit of that leverage.

Having said that, we have a variety of conversations around here about being a compounder and doing something on the inorganic side. This is clearly an asset for us to extract synergy value of anything that we were to buy.

Operator

The next question will come from the line of Scott Davis from Melius Research.

Scott Reed Davis - *Melius Research LLC - Founding partner, Chairman, CEO & Research Analyst of Multi- Industry Research*

Rich, can you give us a little bit more color on retail fueling in China. And just are we still decelerating? Are we kind of at a new normal demand level?

Rich, can you hear me?

Andrey Galiuk - *Dover Corporation - VP of Corporate Development & IR*

Try going unmute.

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

Okay. All right. Yes, that works. Thanks, Andrey. I think this is the last bad comp for us, which was on that double-wall issue. But having said that, the volume that we see out of, primarily, the NOCs in China has been pretty low. We don't -- we had a big conversation around here the other day whether that's because of -- is the volume down, and we're missing out on it? Or is the volume just down? We've gone out to all of our traditional customers in China. We still rate very well in terms of the purchasing programs. I just think that, for whatever reason that 2020 was a down cycle in terms of kind of the bit of NOC build-out of their retail operations. Early to say whether that recovers, and that's not really built into our forecast for '21. But at some point, it's going to have to.

Scott Reed Davis - *Melius Research LLC - Founding partner, Chairman, CEO & Research Analyst of Multi- Industry Research*

Okay. Fair enough. And then just as a follow-up, I mean, you talked a little about inventories, but it's hard to say, just given the diversity of your businesses, of course, but are inventories back to normal, you would say, at the customer level? We've heard below trend line inventories for several quarters now, so are we back to normal and some double ordering?

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

Unfortunately, it's one of these. It depends, Scott, answers. We have businesses like our industrial pumps business that sells through stocking distributors. Our early read here in January is there's an amount of restocking going on because our backlogs and the industrial businesses there are building the same thing with material handling. Those backlogs are building. So I think it's fair to say that everybody was very prudent in terms of inventories on the distribution side.

In '20, they -- now everybody is trying to make 2 calls. What is economic activity going to be in '21? And the second thing I mentioned of, if there are going to be supply constraints as everybody ramps sequentially? Do I got to get in the front foot and get my orders in because there's a potential that some of those deliveries are going to be delayed outside of the quarter. So there's really 2 of those phenomenon going on. Do I think that they're severely under stock? No. But I think that, by and large, our stocking distributors are going to stock based on what they think that the revenue is going to be and -- which is built into our forecast.

Operator

Next question comes from the line of Julian Mitchell with Barclays.

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

Maybe just a first question around any margin color by segment that you can give. I see the $25 million to $35 million guide firm wide on incremental margins. Any segments to call out at being extreme ends of that spectrum? And maybe just to find a point, in DFS, should we expect operating margins to grow this year? Or that might be a challenge because of the EMV mix headwind?

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

There is plurality in terms of incremental margin with the exception of Engineered Products, which would be slightly lower. So let's discuss why, right? The Engineered Products is going to be slightly lower just because of the gross margin within that segment. And despite the fact that DRFE has lower gross margins at the segmental level, the revenue growth there is so high that you're getting a pretty big impact in terms of absorption benefit year-over-year.

So, now, having said that, we do have structural cost savings that are rolling through at the same time, and that depends segment by segment. But I think that my comments here are -- I think you've got your finger on it for DFS because it's a relatively low growth environment, and it is a little bit negative because of the mix, but we think that we can make that up in terms of productivity. So then the hierarchy would be Engineered Products, the lowest, and then plurality, again, across the rest of the portfolio.

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

Great. And then I see the full year guide across the firm. Just wondered perhaps the first quarter, maybe just talk about orders and bookings in recent weeks? And should we expect the first quarter to look maybe a little better than Q4 in terms of year-on-year revenue and margin, but not substantially different until Q2?

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

I think the answer is yes, but that is a calculation that I have not done around here. I can just tell you that what you would expect is the toughest comp is Q1 to Q1 just because it's pre-pandemic to entering into '21, but we expect it to be better vis-à-vis Q1. Clearly, Q2 comp is going to be a relatively low bar to hurdle. And then the back end of the year is going to be as we mentioned during the color on the segments that we have certain businesses that we believe are back-end loaded, either because of seasonality or based on where they are in the recovery of those markets. So we expect to be better in Q1, everybody is going to be better in Q2, and then regular seasonality from there.

Operator

The next question comes from the line of Andrew Obin with Bank of America.

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

Just a question. You're definitely sort of starting to firing all cylinders when it comes to operational storage and starting to deliver consistently on the operational algorithm. But can we just talk about how is your strategy on capital allocation, and, specifically, M&A is evolving going forward? And what kind of opportunities should we be thinking for 2021? And what's out there in terms of availability?

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

I think that the hierarchy, we've been over a variety of different times, so that's unchanged. I think in terms of opportunity, there's plenty out there, and a lot of it is very expensive for all the reasons that we've talked about. We're on the front foot, actually spent more if you go, I don't know what the slide number was, we spent more in '20 versus '19.

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

That's exactly right.

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

We tried to spend a lot more than that, quite frankly, but couldn't get it done because of valuation or a variety of different things. So look, I'm very confident in, as you described it, the operational algorithm here. I think that this is just a roll forward of what we've done for the last couple of years. So our confidence of converting revenue into incremental margin is quite high. I think that we have a lot of businesses that have earned the right to grow in organically. We just got to find the targets and execute on them without getting crazy.

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

Got you. And just a follow-up, I think John has asked you about the supply chain. But how has your thinking about the supply chain has evolved throughout the COVID sort of pandemic? You managed it very well, but anything different that you guys are going to do going forward in terms of where you're sourcing? And I know it's sort of extension of John's question, but maybe more color.

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

Look, I mean, we're not -- our supply chains are relatively discrete. So any moves that we make are -- we're not auto OEM that have to make big strategic decisions based on geopolitics and foreign currency and things like that. So we're changing it all the time to a certain extent. I think that the trade of buying low-value, high commodity price exposure, basic metal working out of Asia and bringing back to the U.S., I think that, that has been dying for a couple of years now. It's part and parcel of the reason that we're making some investments into VSG and ESG right now because we think that we can be more competitive and get the industrial absorption of doing it ourselves to a certain extent. But we're not we're not making big strategic decisions and not making big swings, but we're always trying to adapt the supply chain.

Operator

Next question comes from the line of Joe Ritchie with Goldman Sachs.

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

Rich, maybe following on that last question, your comments around being front footed on M&A. Maybe just the flip side of that argument it's just like, given where valuation levels are right now, you could argue maybe there hasn't been a better time to looking at your portfolio closer in terms of maybe unlocking value on assets that you don't expect to be part of the portfolio longer term. So maybe just some thoughts on that, and how you're thinking about that specifically for 2021?

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

Joe, it's not changed. I mean we're constantly revisiting a variety of pieces of the portfolio. I mean that's really all I can say about it at the end of the day, right? We may have views on individual pieces, but we don't want that to get in the way of us extracting the maximum value that we can out of the pieces that we have. So I spent a lot of time here in terms of portfolio construction on both -- and more on the in than the out. But we screen all of our businesses for their participation strategy and changes in the marketplace and everything else, not so much, "Hey, wait a minute, everybody is paying a lot for things so maybe we should go to market." We look at it more as in terms of its hierarchy in terms of return on invested capital in the group and whether they are advantaged or disadvantaged structurally over the next time horizon.

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

Yes. That makes sense, Richard, and I don't mean this to be a perfect segue, but I did want to talk about food retail to some degree. You talked last quarter about the fact that margins have gotten back to the low teens, remodeling had restarted. I guess, how do we take the comments around like backlog and whether that backlog is building because it's been potentially more difficult to continue on the remodeling at this point, given the coronavirus cases surging? Just want to get a better understanding for whether you're getting on-premise access. And then secondly, how the margins have kind of even trended even beyond the third quarter for the food retail specifically?

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

Yes. I mean, we're expecting big things from the retail food business this year. For sure, a lot of the deferments that happened because of COVID access and a variety of other forces are clearly what's building the backlog into '21. But having said that, we've gone through a 4.5, close to 5-year cycle where there hasn't been even, we would argue, replacement or maintenance spending in terms of global food retail. So there is some pent-up demand there. We think that we have a more competitive product now. We're changing the cost structure of that product.

And as we talked about before, our view is that what the customers really value in this business is being able to have the product available when they want it. And to the extent that now we've changed, are changing the dynamic of our lead times, I think that's beginning to be reflected in our backlog. So this is spent -- the management team of this business has spent 2.5 years, working real hard to transform this business. And our expectations in terms of profitability this year is material in terms of what's baked into our EPS.

Operator

Next question comes from the line of Nigel Coe with Wolfe Research.

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

We've covered a lot of ground already. So I really want to talk about the sort of the framework of FY '21 that you've laid out. And what struck me was your revenue growth range of 5% to 6% is quite tight and it implies good visibility, maybe some consider them. That's my first sort of like top question. And the second is your range for margins, 25% to 35%, is quite a bit wide than we normally see. So we normally see a bit more provision on margins and less provision on revenues and yield vice versa. So I wonder if you could maybe comment on that. And the width of the margin range, is that a function of portfolio mix primarily? Or is there just some uncertainty about raw material? Any color there would be helpful?

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

Yes. Nigel. I mean, look, I would expect that we're going to tighten both those changes progressively as we go through the year. But I mean, you've got your finger on it. I mean, we're predicting even if we go to the organic revenue, which doesn't have FX, the margin does have FX in it. So we're predicting FX in advance of 12 months and we're predicting mix over a wide, diverse portfolio in terms of gross margin. So we need to give ourselves a little bit of latitude there.

As I mentioned in a previous question before, the good news is that refrigeration is coming back and in terms of absolute profits, it's going to be material to the bottom line. That's not really great in terms of consolidated conversion margin just because of the EBIT margin of that particular business. So if you go back to the question, I think, that was just asked before, well, could that revenue be higher?

Are we at an inflection point because there's really going to be -- and we're under forecasting refrigeration for the year. In a way, I hope we are. What that's going to do is push up the top line, but it's going to draw down the conversion margin, but we'll take the absolute profit. So it's our best guess right now. I guess, at the beginning of the year, we'd like to give it some latitude. I think that the history around here has been to try to hit the top, and we've got every intention of trying to do so.

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

Rich, and then my follow-on is really the comment around the prebuy and perhaps or preordering because of supply change constraints, which makes total sense, and we're certainly hearing about supply chain constraints. But are you getting this feedback from customers? Is it your gut instinct telling you that this is happening? And therefore, should we expect there to be maybe a moderation in order rates in 1Q sort of as a consequence of that 4Q dynamic?

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

It is my gut feeling. We have a President -- operating company presidents meeting as soon as we finish up with your question, and that's one of the things we're digging into. But based on what we're seeing, in our own operations and the guidance that we are giving our own operations of if you're seeing constraints out there, you better get on the front foot and start buying components to the detriment of working capital, which we know we can bleed off of the balance of the year, let's not miss out on deliveries and production performance.

So if we're doing it, my expectation is that everybody is doing it. Do I think it's to the detriment of order rates through the balance of the year? No, I don't. Because I think what baked in -- look, there's always going to be volatility quarter-by-quarter. But what's baked into our revenue forecast is shipments, for lack of better word. If there's some amount of -- and look, at the end of the day, you get a backlog that's in excess of your first quarter production, you're probably not going to get it out anyway. So the good news, I think, when I answered Sprague before is, you know what, the longer -- the bigger the backlog that we have, the more efficiently we should be able to run our factories, and that's margin accretive.

Operator

The last question comes from the line of Deane Dray with RBC Capital Markets.

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

Would be interested in hearing what the dynamics are around that natural refrigerant, Rich, that you called out? Can your equipment be used for that? Does it have to be retrofit? And how do you think this trend develops from here?

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

Well, we did a press release on it not too long ago. So you can see our view based on what the ruling for California was. We are a leader in the systems business in Europe, and Europe is probably 3 to 5 years ahead of the United States. So we have the technology. It's now going to be a question of what the adoption rates and whether they are regulatory mandated or do individual retail operations want to, as part of ESG, go green and begin adapting those solutions. So we feel really good about our position in terms of having the technology readily available.

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

Got it. And then just a second question unrelated. If the new administration, as part of the stimulus program, puts through some restrictions about buy American products, how is Dover positioned just broadly, if that restriction comes through?

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

I don't think it would be materially beneficial. Generally speaking, we make and ship in the jurisdiction that we operate in as an overall comment.

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

Could you be flexible in terms of your supply chain in terms of doing some subassemblies in the U.S. to qualify? Just the last time this went through, that's what we saw companies responding -- on the pump side.

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

Yes. I think that if we were a big, vertically-integrated operation, yes, I think that it would be more of a challenge. We don't bring in assemble product of any grand scale that you can break apart in containers and then put value-added on. I mean, I've been through this in previous life. Yes -- look, at the end of the day, I don't think it's going to move the needle for us. The only thing that comes to mind is if we were a component part and somebody wants to source in the United States and had been sourcing -- had been importing it, is that an opportunity? I guess, sure. I wouldn't have any idea how to scale it right now, though.

Operator

Thank you. That concludes our question-and-answer period, and Dover's Fourth Quarter and Fiscal Year Ending 2020 Earnings Conference Call. You may now disconnect your lines at this time. Thank you.