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DOV.N - Q2 2021 Dover Corp Earnings Call

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OVERVIEW:

Co. reported 2Q21 organic revenue growth of 30%. Expects 2021 revenue growth to be 15-17% and adjusted EPS to be $7.30-7.40.

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PRESENTATION

Operator

Good morning, and welcome to Dover's Second Quarter 2021 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 the call. If you do not agree with these terms, please disconnect at this time.

Thank you. I will now turn the call over to Mr. Andrey Galiuk. Please go ahead, sir.

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

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

Our comments today will include forward-looking statements that are subject to uncertainties and risks. We caution everyone to be guided in their analysis of Dover by referring to our Form 10-K and our most recent Form 10-Q for a list of factors that could cause our results to differ from those anticipated in any forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, except as required by law.

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

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

Thanks, Andrey. Good morning, everyone. Our second quarter results were strong across the board, and we are especially pleased with the top line performance, considering the complicated operating environment. The demand environment in the quarter was robust and continued the momentum from the first quarter. And despite posting a 30% organic top line growth, we exit Q2 with a sequentially higher order backlog. I'll focus on the bigger picture here and highlight again what we believe is underappreciated aspect of our portfolio, its organic growth potential.

Our revenue in the second quarter was above the pre-pandemic comparable quarter in 2019 and resulted in the highest revenue first half of the year in recent Dover history, meaning that the majority of our markets are not simply recovering but are operating in a growth environment. New order bookings remain robust, with all segments posting book-to-bill above 1, resulting in sequential comparable growth in backlog, as I mentioned earlier. Operating margin conversion was solid for the quarter as a result of good execution at the operating level and a healthy mix of products delivered in the quarter.

All of this is well and good, but make no mistake, the operating environment remains very challenging. It's been 90 days since the last time we were asked the question about the duration of "transitory inflation." As we've discussed after the first quarter, we had some line of sight on raw materials cost trajectory coming into the year, which allowed us to get in front from a price cost perspective. We have also proactively given our operating companies some leeway on working capital decisions to build inventories based on the backlog trajectory. What we underestimated was the total cost impacts of a strained logistics system and tight labor market that shows no signs of abating.

This has had 2 knock-on effects on our results. First, the absolute cost of inbound and outbound freight were materially higher; and second and more important, the costs associated with production line stoppages due to lack of labor and components caused by trends in time, uncertainty and overall supply chain tightness. I'll deal with the market dynamics and supply chain impact by business later in the presentation. But based on our experience so far, I am concerned about the notion that the current economy needs to be further stimulated and second-order implications of that line of thinking, and I'll leave it at that.

Our teams have done a commendable job navigating these choppy waters and continue shipping products and driving robust margin conversion and strong cash flow. Overall, we believe that our operating model has been an advantage to us as we are largely a localized producer and are not overly reliant on extended supply chains. This is clearly reflected in our top line performance in the quarter.

As we look to the second half of the year, our order backlogs make us confident in our top line trajectory. Our forecast do not incorporate much in the way of an improvement nor deterioration of the operating challenges that we've witnessed during the first half. We're just going to have to power through and work with our suppliers and customers to adapt to the prevailing conditions. We are raising our annual revenue growth guidance to 15% to 17% and our adjusted EPS guidance to $7.30 a share to $7.40 a share. We also expect stronger cash flow as a result of the improved margin performance.

I'll skip to Slide 4, which provides a more detailed overview of our results in the quarter. Engineered Products revenue was up 25% organically. Vehicle Services was strong across all geographies and product lines and had record bookings during the quarter. Industrial automation demand was strong across the automotive sector and in China. Aerospace & Defense posted an all-time record revenue during the second quarter. Waste handling is flat year-over-year as the business continues to wrestle with component and labor availability issues that are constraining product shipments. Importantly, waste handling bookings were robust, and the backlog was up nearly 75% versus the prior year.

Engineered Products is our most exposed segment to input and logistics cost inflation due to materials intensity, contractual pricing dynamics and relatively higher share of international sourcing in vehicle services. You can see it in the margin -- the segment's margin was flat year-over-year as strong volume leverage and pricing increases were offset by input costs and freight inflation as well as labor and component availability challenges.

Fueling Solutions was up 25% organically in the quarter and the strength is above ground and the below ground retail fueling globally, including some remaining tailwinds from the EMV opportunity in the U.S. following the April deadline. Vehicle Wash has had -- has been strong this year, and our recent ICS acquisition integration and performance is ahead of plan. Activity in China and fuel transport remains subdued, but there are signs of Chinese operators reopening their tendering activity. Order backlogs were up 29%, and we expect our software and service business, hanging hardware, vehicle wash and compliance-driven underground product offerings to help offset the anticipated headwinds from the EMV roll off. The segment posted another strong sequential margin performance on higher volume strategic pricing initiatives, productivity actions and mix.

Sales in Imaging & ID improved 20% organically. The core marking and coding business grew well on strong printer demand across all geographies, with China and India driving particularly strong performance. Serialization software also grew ahead of expectations. The digital texting printing business was up significantly against the comparable quarter, when much of their operations were locked down in Northern Italy last year, but nevertheless, the business remains impacted, though we are beginning to see growth in demand for large printers, particularly in Asia and continued growth in ink consumable volumes. Margins improved by 420 basis points on volume, leverage, pricing and productivity initiatives.

Pumps & Process Solutions posted another banner quarter, a 34% organic growth on improved volumes across all businesses except precision components. Demand for biopharma connectors and pumps continue to be strong, driven by vaccine and non-COVID-related pharmaceutical tailwinds. Industrial pumps grew by over 20% on robust end customer demand, with particular strength in China. Polymer processing shipments grew year-over-year and continued strength in Asia and is gaining momentum in the U.S. market. Precision Components were slightly down in the quarter, though demand conditions have stabilized and are recovering well in some end markets and geography, giving us confidence in the second half trajectory. Margins in the quarter expanded by 910 basis points on strong volumes, favorable mix and pricing.

Top line growth in refrigeration and food equipment continued its impressive clip, posting a 44% organic growth. Revenue in the beverage can making doubled in the quarter and bookings nearly doubled as well. The business is now booked into late 2022. Food retail saw a broad-based growth across its product lines. Door cases are now booking into 2022. And the demand for natural refrigerants is driving outside growth in our systems business in the U.S. and in Europe.

Backlog in food retail is now double where it was last year. The heat exchanger business grew on robust demand, and all geographies was rebounding order rates in commercial HVAC in North America and record order intake in EMEA, extending lead times for heat pumps and boilers. Foodservice equipment was up in the quarter on a tough comp, chain, -- actually, on an easy comp and chain restaurant demand is robust, but the institutional market is still recovering. Margins in the segment improved by 580 basis points, driven by strong volumes and productivity actions, partially offset by availability issues with insulation raw materials and labor and food retail operations we expect -- which we expect to subside in the second half.

And I'll pass it on to Brad here.

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

Thanks, Rich. Good morning, everyone. I'm on Slide 6 of the presentation deck. On the top of the page is the revenue bridge. Our top line organic revenue increased by 30% in the quarter, with all 5 segments posting growth, with particular strength in our Pumps & Process Solutions and Refrigeration & Food Equipment segments. FX benefited the top line by about 5%, or $68 million. Acquisitions added $19 million of revenue in the quarter. There were no year-over impacts from dispositions.

The revenue breakdown by geography reflects strong growth in North America, Europe and Asia, our 3 largest regions. The U.S., our largest market, posted 25% organic growth in the quarter on solid trading conditions in retail fueling, marking and coding, biopharma, food retail and can making. Europe grew by 30% on strong shipments in vehicle aftermarket, biopharma and industrial pumps and heat exchangers. All of Asia was up 38% organically on growth in biopharma, marking and coding, plastics and polymers, heat exchangers and retail fueling demand outside of China. China, which represents a little over half of our business in Asia, was up 33% organically in the quarter.

Moving to the bottom of the page. Bookings were up 61% organically, reflecting continued broad-based momentum across the portfolio. In the quarter, we saw organic growth across all 5 segments.

Going to the earnings bridges now on Slide 7. On the top of the chart, adjusted EBIT was up $173 million and margin improved 400 basis points, as improved volumes, continued productivity initiatives and strategic pricing offset input cost inflation. Adjusted segment EBITDA was up 350 basis points.

Going to the bottom of the chart. Adjusted net earnings improved by $135 million as higher segment EBIT more than offset higher taxes as well as higher corporate expenses, primarily relating to compensation accruals and deal expenses. The effective tax rate, excluding discrete tax benefits, was approximately 21.7% for the quarter compared to 21.6% in the prior year. Discrete tax benefits were $11 million in the quarter or $9 million higher than 2020 for approximately $0.07 of a year-over-year EPS impact. Rightsizing and other costs were $11 million in the quarter or $8 million after tax.

Now on Slide 8. We are pleased with the cash performance thus far this year, with free cash flow of $364 million, a $96 million increase over last year. Free cash flow conversion stands at 9% of revenue for the first half of the year, 80 basis points higher than the comparable period last year despite a significant investment in working capital and the impact of prior year tax deferrals that did not repeat this year. Also, as we discussed last quarter, we remain focused on delivering against our customers' strong order rates and build inventory to ensure we can meet the current demand in the second half of the year.

With that, I'm going to turn it back to Rich.

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

Okay. Thanks, Brad. Let's try to pause here for a moment, because this is a complicated slide, but I think it's a transparent view of what we think is going to happen over the second half of the year and includes our current view of the outlook of the second half by segment, provides context of how we are thinking about full year guidance, which I'll get to shortly.

Remember, the demand environment is strong across the portfolio, so let's not try to get overexcited about headwinds or mix commentary. We managed it in H1, and we'll do it again in H2, but this is the reality of the situation in terms of the dynamic of the business. We expect top line and engineered products to remain robust through the remainder of the year based on solid backlog and good bookings trajectory. Momentum in the vehicle aftermarket industrial automation should continue, while we expect the improved order rates and backlogs and solid waste handling and industrial winches to drive solid year-over-year growth in the second half. Aerospace & Defense is expected to be modestly down, largely as a result of a difficult year-over-year comparison on project deliveries.

Supply chain constraints and cost inflation are expected to continue to have a material impact on the segment. Waste handling and automotive aftermarket businesses are our largest business exposed to the trifecta of raw materials inflation, extended supply chains and a larger proportion of assembly labor. Our management teams are winning in the marketplace, considering the headwinds, which is reflected in the growth rate in order books. But we are clearly at the point of having to defend our market position at the expense of the price/cost dynamic, which will be detrimental to near-term margins but not material -- slightly detrimental. We expect Fueling Solutions to provide organic growth for the full year, above our initial expectations on the back of growth in systems and software, recovering underground demand and vehicle wash. Recall that above ground business has a tough second half due to the North American EMV volumes.

Margins in Fueling Solutions will be up for the full year, though we expect modest margin compression in the second half relative to the first half, slightly lower volumes and negative product and geographic mix, which I think that we've covered at the end of Q1 as with less North America volume due to EMV and more international volume that's slightly diluted. Trading conditions in Imaging & ID are expected to continue their positive trajectory for the remainder of the year. Our core marking and coding business is expected to maintain its growth trajectory, with services and serialization products positively impacting performance. Digital textile printing is recovering, and we expect the end of the year, we will be well above 2020 but below its 2019 high watermark. We expect operating margins to remain stable in the second half.

Pumps & Process Solutions should see a solid second half. Demand for biopharma and hygienic applications remain robust, with customers now placing orders into 2022. We are strategically investing in additional cleaning room capacity for this platform to support its growth, trading conditions in industrial pumps are strong and driven by robust and customer demand as opposed to channel stocking. Plastics and polymers is expected to be steady, though this business faces a difficult comparable period due to a strong performance last year. Precision Components will return to growth in the second half as OEM new builds will supplant increased activities at refineries and petrochemical plants. We expect margins to remain strong in this segment, but we may see some minor dilution due to mix on the back half, as our Precision Components business recovers, but the absolute profit trajectory of this segment is in very good shape.

With its large backlog and high sustained order rates, Refrigeration & Food Equipment will finish the year strong, with double-digit growth expected for all operating businesses. New orders in core food retail business have been healthy across the product segments, and the tailwinds from our leadership position in natural refrigerants are driving outside growth for our systems business. We expect to begin to significantly ramp up shipments of our new digital door product.

Belvac continues to work through its record backlog. They are now taking orders for late '22 and even into 2023. Our heat exchanger business is positioned well as they are seeing strong order rates across all verticals and geographies. We have been investing in capacity and new capabilities in these 2 businesses and are well positioned to capture the growth.

Foodservice equipment demand has normalized and returned to growth at restaurant change and institutional business continues to improve. We expect this business to post solid growth in the second half, albeit against a low comparable. We expect margins to continue their seasonally adjusted upward trajectory for the remainder of the year. Improved volume leverage, productivity gains and positive product mix and business mix should more than offset operational challenges related to component and labor shortages, increased logistics costs and input cost inflation.

Moving to Slide 10. We remain on the front foot investing behind our business to support the growth, productivity and long-term portfolio enhancement. Organic high return on investment projects remain our top priority for capital allocation. On the left hand, you can see the sample of the current growth and productivity CapEx projects that we are working on. That add up to $75 million of spend. The project mix is balanced between growth and productivity, with a skew towards new capacity and supporting long-term growth in key priority portions of our portfolio.

Our next priority in capital allocation is strategic bolt-on acquisitions that enhance the long-term growth profile and attractiveness of our portfolio. You can see that with that, all 4 of our recent acquisitions were in either digital or high-growth single-use pumps markets. These are small additions, but we are very excited about scaling up these highly innovative technologies as part of our global portfolio. We remain on the hunt for acquisitions and have a solid M&A pipeline as we enter the second half. Our current dry powder on a full year '21 basis is approximately $3.3 billion.

Our revised annual guidance is on Page 11. We are increasing our top line forecast to reflect the durability and demand trends that we are seeing. We now expect to achieve 15% to 17% all-in revenue growth this year. Our $0.55 adjusted EPS guidance increase is mindful of the supply chain and input challenges we summarized earlier in the presentation, and we expect free cash flow generation to edge higher as well due to margin improvements.

On the bottom of the page, we show our expected '21 performance in a multiyear perspective. We remain on track to deliver strong returns through a combination of robust organic revenue growth, strong margin expansion and disciplined capital allocation.

Before wrapping up, I want to thank everybody at Dover for their perseverance and accomplishments executing in today's challenging environment.

And with that, Andrey, we'll open it up to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Andy Kaplowitz with Citigroup.

Andrew Alec Kaplowitz - *Citigroup Inc. Exchange Research - Research Analyst*

Rich, can you give more color into what you're seeing in terms of margin progression in pumps & process and refrigeration? I know you just talked about it, but if you look at Pumps & Process, you've been sustaining that 30% level. Can you keep doing that? I know you talked about a little dilution there. And then on the refrigeration side, like how would you assess the sort of march toward that mid-teens margin goal that you've talked about?

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

On the Pumps & Process Solutions side of the portfolio, nothing deteriorates in the second half. It's just pure mix. So what I was trying to make clear is one of the businesses that suffered greatly last year and is beginning to improve now is our Precision Components business, that is slightly dilutive to margins. But in terms of absolute profit, it's a positive. So I wouldn't get overly chuffed about that.

On the refrigeration side, we expect third quarter margins to be the highest of the year, just based on seasonality and the size of our backlog and everything else. Quite frankly, we're a bit disappointed in the margin in Q2. I don't think that's the fault of management, but we've had a really difficult time with freight costs and components and labor availability. So on one hand, I think the effort on their part to get the product out the door was excellent. The bottom line is we disappointed a bunch of customers in our inability to get the product out because of the supply chain issues. So the trajectory is good, and as you'll see from the backlogs, this is more of a 2022 story now more than a '21 story.

Andrew Alec Kaplowitz - *Citigroup Inc. Exchange Research - Research Analyst*

That's helpful. And then we know you want to be conservative, given all the cross currents out there, but you obviously are forecasting revenue to come off a bit from Q2, with the backlog up 70%. You talked about EMV coming down, supply chain, and the virus is still out there. But you did mention in your release that you have visibility already into '22. So maybe you can just talk about that visibility. And obviously, it's in Refrigeration, but is it across all the businesses so that organic growth could actually be quite strong as you go into '22?

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

Look, I mean, I'm not going to complain about the size of our backlog. And if you run the calcs on it, we couldn't get it out the door over the balance of the year if we wanted to. So it's up to execution, number one. And with the exception of Belvac and Maag, most of our business is short cycle. So we'll see at the end of Q3.

And I mean, look, at the end of the day, Andy, it's the same discussion we had in the Q1. The demand is there. It's up to us to get it out the door. I think that when all is said and done, I think that we probably are going to do better on average because of our -- because I think that we're advantaged from a supply chain point of view versus some of our competitors. And that's what's going to be winning in the marketplace. It's not so much a pricing dynamic right now. It's whether you can get the product out the door. So we -- I think that right now, I don't -- in my tenure here, we've never had backlogs like this, and it's a good problem to have.

Operator

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

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

Just kind of digging into Andy's question a little bit of a different way. I think, normally, you guys convert your first half orders relatively close as a percentage into sales from first half to second half. Obviously, that suggests like a kind of a stupidly high revenue number for the year relative to your guidance, like $700 million higher. Obviously, there's supply constraints and things may be getting pushed into '22.

Can you maybe just talk about like the mechanics of this backlog, what's converting -- what's different when it comes to the conversion from orders into sales this cycle, if you will? I mean, I'm sure it's much more extended, obviously, this cycle. Maybe like just mechanically, is there double ordering going on? Is there -- are you guys pushing deliveries into '22? Just a little more of the mechanics around that.

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

Sure. I think that we discussed it a little bit at the end of Q1. Clearly, based on our backlogs of exiting Q1 and then Q2, because of the demand function was going to be higher than kind of what a normal seasonality would be, just because of where the demand was. So it's just purely a function where you could get it out the door or not at the end of the day. So that's the good news.

So I don't think you can look at Q2 and just say, well, I'm going to go back and look at history, and then Q3 is this much higher than Q2 and then that it's going to spit out a number. As you said, that's just not realistic, quite frankly. So that's point number one. So I'd be careful about calculating seasonality based on history just because of the strength of the first half, just because of the recovery coming out of the pandemic.

In terms of the backlog, yes, we'd have to break it down because we've got some long-cycle backlog. I mean we mentioned Belvac, which is booking into 2023 now, is a piece of that, that will just convert over time. We don't believe that there's double ordering going on right now. From what we can tell, it looks like it's just a recognition by the customer base of the constraints that are out in the system, that in previous periods, you just didn't have to put the orders in, you want to get in line.

So that is what is expanding the backlog. I mean, I think you asked the question at the end of Q1 about this whole issue of channel stocking, destocking. And we took a close look. I mean we grew our industrial pumps business by 20% in the quarter, so we took over that actually. But -- so we took a close look at channel checks and we don't see that inventory building up at our distributors. It's just passing right through. So that's good news at the end of the day because it means it's fundamental demand.

So I think it's 2 issues. We've got some long-cycle businesses that are booking out well further than, historically, they used to. And then I think on our short-cycle businesses, I think there's a recognition of the constraints in the supply chain that's just making everybody get in line further out than they normally would have.

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

And I guess on that front, on the working capital side, is there any unwind of this big inventory and receivables? I guess, not receivables because your sales are going to continue to grow. But on the inventory side, I mean, any flush you see in the second half? I know you raised your free cash flow guidance, but if there's anything to nitpick at this quarter would be the working capital build was kind of sizable. Any unwind there in the second half?

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

Well, I mean, I think the working capital build has been to our advantage, and we'll see after everybody reports in terms of top line. I mean, having the product available or having the components available to convert has been an advantage to us. I don't see anything fundamentally deteriorating in our working capital. We'll see in the second half, I would expect to see some -- to see liquidation in Q4.

And if we don't, on the industrial working capital side, that means that the demand outlook for '22 is robust. And you know what, we may carry it again, but I don't think that, that just means higher earnings in the outside period. So right now, sitting here, we would expect free cash flow to be up. No real deterioration in terms of the metrics or working capital. We'll leave it at that to see how order rates progress over the balance of the year.

Operator

Your next question comes from the line of Jeff Sprague with Vertical Research.

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

Rich, maybe just touch a little bit more on M&A, right? I mean you've been doing some bolt-ons, but as you know, we've got kind of a multibillion dollar capacity here. Activity seems to be picking up in your neighborhood, right? I wonder if, a, you see things kind of trading away from you that you are interested in? Or just kind of the actionability of what you might have in your pipeline?

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

Yes. Without getting into the specifics, I think that we lost out on one deal that we chased pretty hard due to valuation. Some of the other ones that you've seen transact, we're well aware of those assets, and we're not participating in them. Bottom line is it's a good news, bad news story.

I mean, the bad news is the valuations are what they are, and I'll leave at that. The good news is because valuations are what they are, then there's a lot building up that wants to come to market, because I think this is a recognition of these are the salad days for multiples of not even earnings anymore, but of whatever you want to choose to be the multiple cell.

We're looking at a lot of stuff right now. And We're going to remain disciplined. I mean the things that we've got there are small, but we think that the network effect and the leverage of those small products is -- our expectation that returns are going to be very high in the deals that we did, and we'll see in the second half.

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

And an unrelated different question, just back to kind of price and how you're managing all this. What are you doing differently? I'm sure you can use the demand pulse to just extract price if people want the product bad enough. But are you able to kind of drive deposits, do other things to just kind of improve the commercial terms of how you're transacting with folks?

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

It depends. I think, because demand is high and capacity is tight, you can manage profitability by customer, probably a little bit more efficiently than in the past. But I think in certain of our businesses, and I'll go back to what I talked about at Engineered Products, when you get to the third price increase, do you actually go for the fourth price increase? Because the fact of the matter is you run the risk of demand destruction in the short term. And that's not good.

So part of my comment about Engineered Products, especially around ESG and VSG, is at a certain point, if we go negative in terms of price cost, but the volume remains robust and the installed base goes up, that's a better trade because we believe that some of these supply chain constraints in raw materials will roll off, hopefully, sooner than later. And do you really go back to your core customers and say, "Sorry, but here comes another price increase." So I think that we're managing differently across the portfolio, but we don't want to force short-term demand destruction by trying to just be draconian.

Operator

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

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

Just a question, just to sort of -- to continue sort of to talk about capital allocation. You did sort of highlight over $3 billion in dry powder. How should we think -- you sort of clearly have established yourself as one of the most consistent operators post-COVID. So how do you think about sort of the pace that you would like, right? You assume that valuations stay where they are. But how do you see the pace of capital allocation per year in a normalized environment, assuming that prices stay where they are?

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

I don't know how to answer that. Look, I mean I'll put it in this way, Andrew. What we're realistically looking at right now is about 2/3 of our dry powder. Now do we execute on that or not? I'm not sure. But just in terms of the amount of targets and a realistic view of what the value of those targets are is about 2/3 of our dry powder. So it's quite a bit at the end of the day. But it's a realistic view and there are some deals that we just can't get there. I mean this notion that return on invested capital made a quantum leap from 3 to 5 years over the last 12 months, I find an interesting dynamic.

And I'm not here to criticize anybody's deals. Everybody's got their own strategy to a certain extent. So like I said before, to Jeff's question, the bad news is valuation. The good news is there's a lot of assets that see valuations of transactions in the marketplace. So the amount of opportunities that are out there and the ones that are rumored to come is actually proactive to capital deployment.

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

That's a great answer. And then the other question, maybe I missed it, but did you comment on what the price increase was in the second quarter? And what are you modeling for second half of the year?

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

The price to raw materials improves in the second half of the year versus the first half. The outlier is logistics costs and line stock. This is really the negative headwind. But price cost on the raw material side is actually better in the second half than the first half.

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

But what was the price component of organic growth in second quarter?

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

[2%].

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

Less than 2%, yes, right around that number. Not that significant. It really comes down to -- Andrew, comes down to the timing of when those price increases. Rich is saying, there's multiple times that price is being put in. So it's not one big bang at January 1. It kind of spreads across the year, so you get that effect.

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

Looking at your price reaction today, I don't think anybody is complaining about your execution.

Operator

Your next question comes from the line of Scott Davis with Melius Research.

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

Is there any way to kind of convert the -- Richard made a comment of disappointing customers. I mean can you convert that to kind of an on-time delivery number to us and kind of what's normal and what you're at now? Or any way to kind of think about it other than subjectively?

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

Well, I mean, there's really 2 dynamics. I think that our lead times are disappointing to our customers, because you go for years where you can convert orders within -- with intra-month in some of our businesses, where that's just not possible. And that's where you get this function of now everybody's seen it for 6 months, and so it's got a knock-on effect to backlogs because there's a recognition of this is more durable than maybe everybody thought.

So the positive is it builds your backlog at the end of the day. The negative is our lead times have stretched out. Now you couple that with in certain of our businesses where we've had some pretty difficult logistics constraints and, in some cases, labor availability and then you've got disappointment of we say we're going to deliver the product on X date, and we miss it, and that's happened.

So we can -- we quantify it more in dollars and cents. I'd have to go look up in terms of on-time delivery. I think, across the board, it's probably okay, but there's -- as I mentioned before, a business like VSG that's got probably our longest extended supply chain is suffering the most as opposed to printing an ID that just doesn't have to deal with the reality of that.

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

That's a fair point. And so just to follow up, I mean all the questions on M&A, I think, are appropriate just given where your leverage ratio is. But you could flip it over and just say, well, valuations are crazy, why not sell some assets here, because you do have a fairly broad portfolio and some things seem to fit better than others. And is there any appetite to doing so?

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

No, I think that's a fair comment. I guess that's all I can say about that. But you're right, right? Valuations inbound and outbound are what they are, and you could manage that both ways.

Operator

Your next question comes from the line of Julian Mitchell with Barclays.

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

Just wanted to circle back maybe to Slide 9. So just to try and understand, essentially, it's the point here that sort of this is largely relating to a half-on-half margin outlook, and so sort of company-wide second half segment margins are may be down slightly versus the first half. And then within that, you've sort of got DEP and DFS maybe down a bit, DRFE flattish and then DII and DPPS flat to up half-on-half. Is that the right sort of summary of that slide, just to make sure it's sort of half-on-half we're looking at?

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

Yes. I think that if you overlay the -- my comments on to the slide, they're going to match, right? I think that we're just giving you an honest assessment based on the prevailing market conditions of where we have headwinds operationally, price cost and then some commentary on mix, which is a commentary H1 to H2. So as I mentioned in my comments, I don't think we have to be overly dramatic about it. We've managed it quite well in the first half, and I don't expect us to manage it differently in the second half, but we have to recognize that there are certain decisions that we're making, like if you look at DEP in terms of price cost, which whether from an absolute profit point of view, may be in good shape with slightly dilutive margins because we're just making a choice to chase the volume, which I think is appropriate in that case.

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

That's very clear. And then secondly, looking at the cash flow, you've addressed the working capital point once or twice. Capital spending is up a decent amount this year, I think a sort of low double-digit type increase year-on-year. Just trying to think about sort of the outlook from here, how much does that reflect the sort of catch-up spend? You laid out some projects in the deck after a weaker CapEx number last year for obvious reasons. And how much is this sort of a sustainably higher level? Just trying to understand how your capital intensity looks on the CapEx front beyond 2021. Should we see CapEx normalize lower again or be flat when we look at next year?

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

Well, I mean I think that '20 we can just throw out, right? I mean, at the end of the day, everybody reacted to the change in market conditions appropriately. So as a percent of revenue, we'll see where we end up. And I don't want to do the calculations here, but as a percent of revenue, '19 to '21 is probably flattish. And I would expect that to be the same going into '22.

I mean, we -- one of these days, we're going to do a presentation on our returns for organic investment, and they absolutely blow away anything that we do inorganically. So to the extent that we find the projects going into '22, we'll spend it internally. But right now, sitting here today, do I expect, as a percent of revenue, do it go up dramatically in '22? No.

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

That's helpful because I think, yes, there's a lot of sort of broader chat about CapEx super cycles and this and that, which I think is a bit odd. It doesn't sound like from Dover's sort of internal outlook that there's anything game changing in terms of CapEx intensity as we look out.

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

Well, I think that there is an interesting argument, and I would agree with it that to the extent that labor inflation is durable and that supply chains -- the issues that we're having in supply chains will improve, but not dramatically. There's an argument to be made that the returns on automation are going to be better than they've been over the last 5 to 6 years. And I would agree with that.

Operator

Your 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*

I'm going to ask Julian's question maybe a little bit more explicitly on the margins for the second half of the year. And so it sounds like, Rich, you guys have done a great job managing this historically. When I look at Slide 9, basically, what I'm hearing from you is that incremental margins are probably going to be pretty comparable to the kind of 30% range that you just put up in the second quarter. Maybe there's some slight pressure, but that's kind of how you're thinking about this for the second half. Is that fair?

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

Yes. I think that we're just trying to be transparent, Joe, right? It's very -- we could have put up the second quarter results and said everything is great, and see you next quarter and gotten away with it. But I think that we have to recognize that there are some issues that need to be overcome.

To us, I don't think that we should get overly excited about it. It's just the facts are the facts. We've dealt with them in H1. If anything, it becomes more of a mix issue in Q2 and that's not problematic. So as I mentioned before, DRFE is going to have its best quarter of the year from a revenue and an operating margin point of view. So that's great in terms of absolute profit, but it is dilutive to overall group margins.

So am I going to tell them to slow down to protect the margin? No, at the end of the day. And that's the case and there's a couple other of our businesses. I mean, if precision components on the back half, revenue increases, but it's slightly dilutive to a, let's call it, a very robust margin that we're clocking at Pumps & Process Solutions. Again, I don't think it's overly problematic. But we're just trying to guide everybody of -- hey, look at the margin in Q2, but read from a seasonality point of view. If I go back and look at history, Q3 is x percent higher than Q2. So let me just model that and run down the field. I think that would we give you a number that we would like to get to, but I'm not entirely sure just because of the pull forward in terms of the demand and the operating leverage that we're getting in Q2.

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

And we got to be a little bit careful with the conversion to the back half as well because priced materials does impact conversion. So just keep that in mind is that, that has nothing to do with absolute profits per se, as Rich has talked about. But the conversion rate is influenced by that.

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

Sure. No, that makes sense. And I fully appreciate all the color you guys are providing. I guess my one follow-up and maybe just kind of focus on the near term for a second. When you think about third quarter from a pure revenue and EPS perspective, would you expect it to be up versus the second quarter or similar? I'm just curious like how you guys are thinking about it with the way that the backlog is kind of converting into your business?

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

Similar, I guess, is the answer.

Operator

Your next question comes from the line of Mig Dobre with Baird.

Mircea Dobre - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

I also want to ask a question about Slide 9. You've got...

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

Next quarter, I'm going to learn slides. All right, go ahead.

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

You're going to [queue] that slide to next quarter.

Mircea Dobre - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

You've got a -- you've got positive commentary on price cost for DI and DPPS. And just kind of looking through your disclosures in the Q, these were the segments with, frankly, the smallest pricing gains in the quarter, both of them are a little over 1%. So I find that to be a little bit counterintuitive, right? You've got less of a pricing tailwind in these 2, yet you expect better price cost dynamic. Can you maybe put a finer point on this, what's happening with these 2?

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

Well, I think Brad addressed it in an earlier question. I think everybody -- we don't do our pricing on January 1, right? It's done differently. There's signaling effect to manage backlog. So you basically, in certain businesses, will say, we're going to do a price increase at the end of Q1, meaning so you lose that clocking period in Q1, so it actually ramps over the balance of the year on the comp. So again, it is just a reflection of the timing all those price increases and kind of the H1, H2 effect of that.

Mircea Dobre - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

Okay. Got it. Sorry, I missed that. Then I guess my follow-up, just sort of looking at your order intake, right, in Refrigeration & Food Equipment, Pumps & Process Solutions, in both these segments, you're running well ahead of what we saw pre-COVID. And I guess my question is, if we're not talking about some kind of a CapEx super cycle here, what is really happening with these end markets? And is it fair for us to think that this is sustainable to some degree into 2022? Or is there a hangover to be expected here as things normalize?

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

Let me see. I think I've tried to answer this about 15 different ways. I think that backlogs are building, which is a reflection of constraints in the system. So I think when we get to next year, it's going to be an interesting dynamic because as those constraints come down, then lead times are going to come down, which is going to be negative to backlogs to a certain extent. But that -- I think that Steve asked the question or maybe wrote it earlier today, I think we've got to get -- we've got to be careful with absolute backlogs and doing math on it and trying to extrapolate revenues into the future.

I mean the bottom line is that backlogs build and shrink based on lead times and market conditions and everything else. So could I envision a scenario where backlogs come down? Yes. Do I think that's overly problematic? No, because to a certain extent, that means the headwinds that we have on supply chain logistics are getting better, which is better for margins at the end of the day.

Mircea Dobre - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

Yes. So Rich, to clarify, I wasn't talking about backlog because I totally agree with what you're saying. I was wondering more about your bookings, right, which have been very, very strong year-to-date even relative to pre-COVID.

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

Yes. Well, look, I mean, I think that we are executing really, really well in Pumps & Process Solutions. I mean we made a presentation on that, on what we thought was coming at the end of '20. And look, and as I mentioned at the end of Q1, we think that we are in a minimum of 3-year cycle of the demand function on DRFE, which is positive. And it's not just -- it's across the board. It's not just door cases, it's systems business, it's swept on the heat exchangers and it's Belvac, all of which we believe are in a multiyear cycle.

Operator

Your 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*

We covered a lot of ground here. It came up multiple times, about component and labor shortages. So, Rich, if you could just take us through, like where is it most acute today on the component side? Is it semiconductors, printed circuit boards? Are you qualifying new suppliers? So that's the component side. And then on the labor side, any color there, unfilled positions. Are you expecting a significant step-up in labor costs as this needs to adjust? So take us through that, if you could.

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

Well, we've got a pretty wide portfolio, I'll make some general comments about the components. They're all tight. They're more problematic if they're large and imported, because if you take a look at what's going on in the logistics supply chain and the Port of Los Angeles and all that, it is a bloody mess, right now, which only impacts a small portion of our portfolio because, as I mentioned in my comments, at the end of the day, we think that we are winning in the marketplace because we don't have a lot of instances of that. If you've got very long supply chains and it's containerized freight coming out of Asia, back to North America to fulfill demand, you're suffering, quite frankly.

On the labor side, it's purely in our operations that I have a higher propensity of assembly labor. And for all the reasons that we can understand, that's been difficult. I think it's not getting worse as we move through the second quarter, which is the good news. So hopefully, in September, when some of this government influence in terms of the labor market begins to roll off, that it will get better and everybody is going to go back to school in September. So our view right now is it's probably going to remain difficult through August. And I think that we're hopeful in September that the situation is better.

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

That's really helpful. And then last one for me. Just you talked about this last quarter and how did it play out, where you said you were going to give the business units more autonomy in managing their own working capital, that you gave them a green light, go ahead and build inventory? And I know there was some surprise there because you hadn't done that before. But how has that worked out? Is that going to be a permanent -- was that a onetime event just you needed to get in front of this demand? But just some color there would be helpful.

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

I mean, if the demand holds up, then we'll continue to kind of give them that latitude because the absolute profit versus the carrying cost of the working capital, the math works, I guess, the best way I can say it.

I would expect, if we get improvement in the logistics supply chain, that it will come down naturally because that's what's really driving it at the end of the day. We're basically giving the green light to everybody of you've got the backlog, don't be reticent of trying to get the subcomponents in because we want to convert.

Operator

Thank you. That concludes our question-and-answer period and Dover's Second Quarter 2021 Earnings Conference Call. You may now disconnect your lines at this time. Have a great day.