OVERVIEW:
Co. reported 2Q20 results. Expects 2020 adjusted EPS to be $5.00-5.25.
CORPORATE PARTICIPANTS

Andrey Galiuk  Dover Corporation - VP of Corporate Development & IR
Brad M. Cerepak  Dover Corporation - Senior VP & CFO
Richard Joseph Tobin  Dover Corporation - President, CEO & Director

CONFERENCE CALL PARTICIPANTS

Andrew Alec Kaplowitz  Citigroup Inc., Research Division - MD and U.S. Industrial Sector Head
Andrew Burris Obin  BofA Merrill Lynch, Research Division - MD
Charles Stephen Tusa  JPMorgan Chase & Co, Research Division - MD
Deane Michael Dray  RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst
Jeffrey Todd Sprague  Vertical Research Partners, LLC - Founder & Managing Partner
John George Inch  Gordon Haskett Research Advisors - MD & Senior Analyst of Multi-Industrials
Joseph Alfred Ritchie  Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst
Joshua Charles Pokrzywinski  Morgan Stanley, Research Division - Equity Analyst
Julian C.H. Mitchell  Barclays Bank PLC, Research Division - Research Analyst
Nigel Edward Coe  Wolfe Research, LLC - MD & Senior Research Analyst
Scott Reed Davis  Melius Research LLC - Founding Partner, Chairman, CEO & Research Analyst of Multi-Industry Research

PRESENTATION

Operator

Good morning and welcome to Dover's Second Quarter 2020 Earnings Conference Call.

Speaking 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, Laurie. Good morning, everyone, and thank you for joining our call. This call will be available for playback through August 12, and the audio portion of this call will be archived on our website for 3 months. So I will provide non-GAAP information and the reconciliations between GAAP and adjusted measures are included in our investor supplement, 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 on 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 second quarter 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.
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 with a summary of the results on Page 3. We expected Q2 to be challenging and in preparation, we reinforced our cost-out program earlier in Q1 so we were in some sense prepared for the battle. We entered the quarter with a comprehensive set of actions to manage through the turbulent times and focused on what we could control, our operations, costs and importantly, safety of our employees.

From an operational point of view, we are not out of the woods yet, but a significant majority of our facilities are up and running moving into Q3, which is positive to operating leverage as compared to this quarter. Top line trends were very much in line with our expectations entering the quarter. Revenue declined 16% organically and bookings declined 21%. Trends are improved through the quarter, and we saw a material sequential improvement in June. We still carry a strong backlog across all segments, and that increases our confidence for the second half.

Our margin performance for the quarter was acceptable considering the state of business activity in April and May. After profitability gains in Q1 on lower revenue, we targeted 25% to 30% decremental margin for the full year. Thanks to the broad-based cost control efforts to offset under absorption of fixed costs and steady execution of $50 million of in-flight initiatives, we achieved 27% decremental margin in Q2, a quarter which we expect to be the trial for the year. That puts us on track to exceed our initial full year target. In addition to the tight cost controls and variable costs, we took further structural cost actions in the quarter as part of our business realignment activities, which will benefit us in the second half.

Along with our cost actions, our proactive working capital management resulted in cash flow improvement. In both absolute and conversion terms, we generated $78 million more in free cash flow than the comparable quarter last year. As a result of our first half performance and our solid order backlog, we are reinstating our annual adjusted EPS guidance to $5 to $5.25 per share. To be clear, even with a strong backlog and positive recent trends, we still see demand uncertainty in our markets and are not back to business as usual. But our teams have proven their ability to manage costs and operations, and we are prepared to operate and achieve results in a wide variety of scenarios that would may be in store for the second half.

Let's take a look at the segment performance on Slide 4. Engineered Products had a tough quarter, particularly in shorter cycle and CapEx-levered businesses like vehicle aftermarket, industrial automation and industrial winches. Waste hauling and aerospace and defense were more resilient, shipping against their strong backlogs. Lower volumes led to margin decline versus a very strong margin that this segment posted in the comparable quarter last year, and we have taken structural cost actions in this segment which will support its margin in the second half along with recovering volumes.

Fueling Solutions saw continued strong activity in North America driven by demand of EMV-compliant solutions, whereas Europe and Asia declined due to COVID-related production and supply chain interruptions as well as budget cuts and deferrals in response to the decline in oil prices. Increased margin performance was commendable with 80 basis point increase on a better mix pricing and ongoing productivity actions.

The sales decline in Imaging & Identification was driven predominantly a steep decline in our digital textile printing business, which we expected given the significant dislocation in global apparel and fashion markets due to the pandemic.

Marking and coding showed continued resilience on strong demand for consumables and fast-moving consumer goods solutions. This is our highest gross margin segment, so decremental margins are challenging and require heavy lifting on cost containment. Our marking and coding business did a good job achieving a flat margin year-over-year, and we have taken proactive actions to manage the cost base in the digital printing business. As a result of these actions and a pickup in textiles consumable volumes, we expect performance to improve in the second half.

Pumps & Process solutions demonstrated the resilience we expected. Its top line declined the least among our segments despite a challenging comparable from last year. Strong growth continued in biopharma and medical applications with colder products posting record growth in the quarter. This was offset by a moderate decline in industrial applications and materials slowing in energy markets.
Our plastics processing business revenue decline in the quarter as a result of shipment timing. We expect to it -- for it to do well in the second half off a strong backlog. As you can see, the segment continued to deliver a solid margin performance, posting improving margin on declining revenue for the second quarter in a row. We expect this segment to deliver flat or improved absolute profit for the full year.

Refrigeration & Food Equipment declined as food retailers continued to delay construction and remodels due to peak utilization and the commercial foodservice market remains severely impacted by restaurant and school closures in the United States.

Our heat exchanger business showed resilience, particularly in non-HVAC applications. On the margin side, negative absorption on lower volumes drove the margin decline. In Q2, we took structural cost actions in this segment, which paired with ongoing productivity and automation initiatives yielded a materially improved margin performance in the month of June. We expect these benefits to continue accruing in the second half and expect the segment to deliver year-over-year growth in absolute earnings and margin in the second half of this year.

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 5. On the top is the revenue bridge. As Rich mentioned in his opening remarks, the top line was adversely impacted by COVID-19 with each segment posting year-over-year organic revenue declines. FX continued to be a meaningful headwind in Q2, reducing top line by 1% or $24 million. We expect FX to be less of a headwind in the second half of the year. Acquisitions were effectively offset by dispositions in the quarter.

The revenue breakdown by geography reflects relatively more resilient trends in North America and Asia versus the more significant impacts across Europe and several emerging economies like India, Brazil and Mexico. The U.S., our largest market, declined 10% organically with 4 segments posting organic declines, partially offset by growth in retail fueling.

All of Asia declined 14%. China, representing approximately half of our business in Asia, showed early signs of stabilization posting an 11% year-over-year decline in the second quarter, an improvement compared to a 36% decline in Q1. Imaging & Identification and Engineered Products were up in China while Fueling Solutions declined due to the expiration of the underground equipment replacement mandate and also slower demand from the local national oil companies.

Europe was down 19% on organic declines in all 5 segments.

Moving to the bottom of the page. Bookings were down 21% organically on declines across all 5 segments, but there are reasons for cautious optimism as we enter the second half. First, as presented in the box on the bottom, June bookings saw a significant improvement off of the May trough with all 5 segments posting double-digit month-over-month sequential growth. Second, our backlog is up 8% compared to this time last year driven by our longer-cycle businesses and the previously mentioned intra-quarter improvement in our shorter-cycle businesses. We believe we are well positioned for the second half of the year.

Let's move to the bridges on Slide 6. I'll refrain from going into too much detail on the chart. But the adverse top line trend drove EBIT declines, although our cost containment and productivity initiatives helped offset overall margins to hold up at an acceptable decremental. In the quarter, we delivered on the $50 million annual cost-reduction program, which focuses on IT footprint and back-office efficiency, and took additional restructuring charges that add to the expected benefits. We also executed well in the quarter on additional cost takeout to offset the absorbed -- under absorption of fixed costs previously estimated at $35 million to $40 million. Some of these recent initiatives will continue supporting margins in the second half and into 2021.

Going to the bottom chart. Adjusted earnings declined mainly due to lower segment earnings, partially offset by lower interest expense and lower taxes on lower earnings. The effective tax rate, excluding discrete tax benefits, is approximately 21.5% for the quarter, unchanged from the first
quarter. Discrete tax benefits in the quarter were approximately $2 million, slightly lower than the prior year’s second quarter. Rightsizing and other costs were $17 million in the quarter or $13 million after tax relating to several new permanent cost-containment initiatives that we pulled forward into 2020.

Now moving to Slide 7. We are pleased with the cash generation in the first half of the year with year-to-date free cash flow of $269 million, a $126 million or 90% increase over last year. Our teams have done a good job managing capital more effectively in this uncertain environment. We have seen strong collections on accounts receivables and continue to operate with inventories that’s supportive of our backlog and order trends.

Q2 also benefited from an approximately $40 million deferral of U.S. tax payments into the second half of the year. Capital expenditures were $79 million for the first 6 months of the year, a $12 million decline versus the comparable period last year. Most of our in-flight growth and productivity capital projects were completed in the second quarter, so we expect to see continued year-over-year capital expenditure declines in the second half.

Lastly, now on Slide 8. Dover’s financial position remains strong. We have been targeting a prudent capital structure, and our leverage of 2.2x EBITDA places us comfortably in the investment-grade rating with a safety — with a margin of safety.

Second, we are operating with approximately $1.6 billion of current liquidity, which consists of $650 million of cash and $1 billion of unused revolver capacity. When commercial paper markets were fractured at the outset of the pandemic in March, we drew $500 million on our revolver out of an abundance of caution. Markets have since stabilized and we reestablished our commercial paper program and fully repaid the revolver. In Q2, we also secured a new incremental $450 million revolver facility to further bolster our liquidity position. As of June, we have no drawn funds on either revolver. Our prudent capital structure, access to liquidity and strong cash flow have allowed us to largely maintain our capital allocation posture. We have deployed nearly $0.25 billion on accretive acquisitions so far this year, and we continue to pursue attractive acquisitions.

Finally, we are lifting our recent suspension on our share repurchase and will opportunistically buy back stock should the market conditions dictate.

I’ll turn it back over to Rich.

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

Okay. Thanks, Brad.

I'm on Page 9, which is an updated view of the demand outlook by business we introduced last quarter. Here, we are trying to provide you with directional estimates of how we expect segments to perform in the second half relative to the second quarter in lieu of full year revenue guidance. I'll caveat that all of this is based on current reads of the markets and is subject to change as the situation remains fluid.

First, in Engineered Products. Shorter-cycle businesses such as vehicle service and industrial automation have shown improvement late in the quarter, and the trends are improving globally. Additionally, aerospace and defense continues operating from a large backlog of defense program orders. Waste handling may see some headwinds driven by tightening of industry CapEx and municipal finances after several years of strong growth performance. Bookings have slowed in late in Q2 as customers paused their capital spending to manage liquidity. We are watching the dynamics closely, but we have started addressing the cost base in this business proactively.

Fueling Solutions is a tale of 2 cities. North America, approximately half the business remain resilient both on EMV conversion and also willingness of non-integrated retailers to continue investing in their asset base. In Europe and Asia, integrated oil companies represent a larger share of the network, and capital budget cuts resulting from oil price declines are having a more negative impact on investment in the retail network. Plus recall, we are facing a $50 million revenue headwind in China this year from the expiration of the underground equipment replacement mandate. Despite some of the top line headwinds, with robust margin accretion to date, we expect segment to hold its comparable full year profit line despite a decreasing top line.
Imaging & Identification outlook is improving. Our service and maintenance interventions resumed in marking and coding as travel restrictions were lifted, and we are seeing a resulting pickup demand for printers. Our integration activities with Systech acquisition are proceeding as planned. We started seeing some green shoots on the digital textile printing side where we are forecasting a difficult year as global textiles will take time to recover.

And Pumps & Process Solutions is expected to show improved trajectory from here. First, our plastics and polymer businesses will ship against its significant backlog in the second half. Biopharma and medical is expected to continue its impressive growth. Industrial pumps, a shorter-cycle business, is expected to start gradually recovering. A material portion of demand in our pumps and precision components businesses is levered to maintenance and repair and aftermarket. The oil and gas, mid and downstream markets served primarily by our Precision Components business, continues to be slow as a result of deferral of CapEx and refurbishment spending in refining and pipeline operators.

In Refrigeration & Food Equipment, we believe the worst is behind us for this segment. Bookings were relatively resilient for the segment and we have improved in June, resulting in a robust backlog that we are prepared to execute against. We also saw grocers restarting the construction and remodel projects resulting in us being fully booked for refrigeration cases into Q4. Additionally, Belvac is scheduled to begin shipments against its significant backlog, which will be accretive to segment margins. Recovery in volumes along with cost actions we’ve undertaken should result in positive margin and profit trend through the remainder of the year, resulting in the segment posting a second half comparable profit increase.

Let’s go to Slide 10. As a result of the fluidity of the COVID situation, we are cautious about guiding top line trajectory at this time, but everything points to sequential improvement from here across most markets. The proactive cost management stance we took in Q1 and continued in Q2 has positioned us from a margin performance standpoint. And today, we are improving our target for annual decremental margin to 20% to 25%. We continue working the pipeline of restructuring actions, including those targeting benefits in 2021, and we are positioned well to deliver on our margin objectives. We remain confident in the cash flow capacity of this portfolio and are reiterating a conversion target above 100% of adjusted net earnings and a cash flow margin target of 10% to 12% compared to 8% to 12% target we had last year.

The rest of the slide, Brad covered earlier in the presentation. I’ll conclude with the following. We have reintroduced EPS guidance as a result of our confidence in our ability to manage costs in an uncertain demand environment. We have a good team and they understand the playbook. Having said that, make no mistake, we are on the front foot from here on driving revenue growth, both organically and inorganically. We have strong operating companies and a strong balance sheet with which to support them. This is not the time to hunker down and wait for the storm to pass. So we’re equally focused on market share gains, new product development initiatives as we are on our main pillars of synergy extraction from our portfolio, all of which we continue to fund despite the market challenges. Inorganically, we have available capital to deploy and I fully expect to be active in the second half.

In summation, I’d like to thank everyone at Dover again for their continued perseverance in these difficult times.

And with that, let’s go to Q&A. Andrey?
Richard Joseph Tobin - Dover Corporation - President, CEO & Director

Thanks, Andy.

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

You mentioned material sequential improvement in June. Are there any of your shorter-cycle businesses that have not improved as fast or faster than expected? And can you give us more color on if you've seen any sort of slowdown in the rate of improvement in late June and July, particularly in the U.S.?

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

We would have not given out full year EPS guidance without seeing June. That's how I think that we mentioned that when we ended Q1 that June was very important in terms of what we thought the trajectory was. And so I mean, I think that we went through the bookings change of June and made a variety of different comments about the business about the moving parts of who is improving and who's not. I mean I don't want to go through all the companies again. We've got a few like digital printing, like foodservice that have not improved and we don't expect them to improve. So at the end of the day, that's not built into our guidance. But we called out a few of the shorter-cycle businesses like aftermarket automotive, for example, which has picked up significantly at the end of the quarter. So June was good. I think that we're pleased it was material to the quarter earnings, June. The profit -- the absolute profit in June was double what we made in April, just to put it in contextually. So I think if you go back and you look based on the -- I think whatever slide it is in here, the Slide 9, that gives you the color, all the color I can give you in terms of the trajectory of the portfolio and the moving parts.

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

Great. And then your commentary on Refrigeration & Food Equipment was relatively optimistic. Maybe talking about the second half of the year, as you said, backlogs continue to improve. Have your customers given you more of an indication that they're ready to let you into their stores yet? And then we know your automation project was start up in July, so maybe just update us on that. And maybe you can give us a little more color on sort of the margin trajectory in the second half of the year.

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

Sure. Let's start with refrigeration. We are booked into Q4, so it's up to us now to produce the product without having any frictional costs. And based on the margin that the business delivered in June, if we can get that for the full quarter, I think -- and which is our expectation, I think we'll be pleased. In addition to that, part of the large backlog that we have in the segment is geared towards Belvac. So we are on the front foot in terms of capacity expansion in aluminum can making, and we're participating on that. And we've got some relatively large projects that we'll begin building at higher rates in the second half.

And in all honesty, I mean if we put food service equipment aside for a moment, we don't have the hardest comp in the second half. It's not as if we exited 2019 firing on all cylinders. So we will -- that's why we will do better H2 to H2 on a comparable basis, but it's largely as a result of heat exchangers continuing to improve modestly over the second half, Belvac shipments and material improvement in refrigeration cases.

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

And then the automation project itself.
Richard Joseph Tobin - Dover Corporation - President, CEO & Director

That’s baked into the margin improvement that we expect in the second half.

Operator

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

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

Rich and Brad, can you give us just a sense of this shape of recovery in China? It’s -- this quarter, I think you said it was down 11%. Is 3Q then become -- I mean if you had to guess, is it more flattish or is it still down and with the chance of being up in 4Q?

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

Look, all of the relative decline or substantially all of the relative decline in the quarter is because of this double-wall tank issue, which we had guided at the beginning of the year. I think that if we remove that, we were -- I believe we were flat to slightly up on the balance of the businesses. So that’s going to be a headwind for us in the second half. Scott, I haven’t done the calculations of what that means quarter-by-quarter. But we always had that $50 million headwind that we were going to have to deal with. It’s a bit slow on top of that in Fueling Solutions just because the national oil companies in China aren’t spending any money right now. But if I -- if we eliminate Fueling Solutions, the balance of our business, which is mostly printing and ID, have improved materially in Q2 and we expect that to continue for the balance of the year. And that’s volume related, right? So as China has restarted and business activity started, you can think about marking and coding, it’s the consumption of consumables and things like that.

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

Okay. That’s helpful. And then just a quick follow-up on CapEx. I mean you’re running at lower-than-usual levels I guess or lower-than-we-expected levels. And do you anticipate that having to go up meaningfully kind of 2021? Or do you think -- I mean I can’t imagine you’re going to need a lot of capacity, but a few facilities that need to be invested in, et cetera? Or is there -- or is this going to potentially continue through 2021?

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

Well, over, I would say the last -- where are we now? July. Over the last 8 to 10 months, we’ve had approximately $80 million of spending that were attributed to 2 projects. One was the automation project for refrigeration cases and one was the brand-new building that we built for colder products up in Minnesota. So those -- I don’t -- we don’t have any in the pipeline of that quantum. So I would expect CapEx to slightly rise in 2021, but not materially as if we’ve deferred CapEx in 2020 and we’ve got catch-up in 2021. Now having said that, you know what, if we’ve got the demand and we’ve got some projects in that we don’t have in the pipe, we’re more than happy to invest organically in this business based on the returns we get.

Operator

Your next question comes from the line of John Inch of Gordon Haskett.
John George Inch - Gordon Haskett Research Advisors - MD & Senior Analyst of Multi-Industrials

Rich and Brad, the $13.4 million of cost actions you took in the quarter. How much of that was -- how much of that maps against the original $50 million target and how much was new incremental structural? Because I think, Rich, you had called out some new incremental structural in a couple of the business segments in your prepared remarks.

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

That is the new structural. So the $50 million...

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

Okay. So that's all new structural.

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

Yes. The $50 million was done and dusted, and it was, on average, $13 million a quarter. That's what we got in this quarter, and that's what we can expect rolling through the other 2. The charge that we took for restructuring in Q2 was new. It was a project that we were working on, we just pulled it forward. So it will have an impact in the second half of the year, but that's baked into our EPS guidance.

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

So the $50 million or the $13 million, that's kind of baked in the cake. And based on your intentions, Rich, when we exit 2020, how much more annualized structural do you think you will have gotten out annualized? So not necessarily all in 2020 by the time we exit 2020. Incrementally, just do the...

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

No. I know where you're going. But let's give us another quarter because we've got some more other actions in the pipeline. And when we get to the end of Q3, we can kind of give you some color on where we're tracking on the $50 million for 2021. But it's a bit premature right now.

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

Okay. So just to be clear, this is stuff that you're doing that is targeted at sort of baking in the cake for 2021, $50 million? Or is this -- do we have like a $50 million annually and then we have this downturn and you go, "Oh, well, we can even more on top of that?" Or this is all part of that progression of the $50 million?

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

Yes. I think as what we said at the end of Q1, we're not just going to sit here and wait for the clouds to part, right? We're being -- we're taking some action on the front foot. These are projects that we had in the pipeline. And because the level of business activity that we had, we just said, why do we do it now. So that action was taken. So they are incremental to the 2020 $50 million. They'll accrue some benefit in the second half of 2020. And then we'll redo all of what we think that we've got in the pipe for 2021 likely at the end of Q3.
John George Inch - Gordon Haskett Research Advisors - MD & Senior Analyst of Multi-Industrials

And then just as a follow-up, what sort of temporary cost actions? Is there a way, Brad, to quantify those like you could call it furloughs or T&E? And I'm curious then, Rich, given the environment, right, like a lot of companies are realizing, "Oh, people can work from home. We don't need as much travel." What is your thought process towards turning some of those temporary cost saves, if you could give us the magnitude into, say, more permanent cost saves depending on how the economy unfolds.

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

Well, look, at the end of the day, the temporary cost savings as a result of managing bonus accruals, we would expect and hopefully to build those back next year. So those come back. The variable costs, mostly in SG&A, I think the jury is still out. I think that clearly, we, like everybody else, have recognized that what we need to conduct business may be different in 2021 than what we'd look back historically. So when we get ready to do our plans at an operating company level for 2021, the conversations we're having or operating with company presidents is, this is a notion of, "Okay. Well, I can go put my '19 SG&A back as long as the revenue supports it." But I think it's a bit premature to kind of monetize that now. But clearly, we're thinking about it. And I don't expect that we'll just snap back from an SG&A point of view back to '19 levels.

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

That makes sense. And is there a way to quantify what sort of cost actions temporarily you took because of COVID in the quarter or sort of the run rate or whatever?

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

Oh, look, at the end of the day, we had a $35 million to $40 million fixed cost absorption headwind that we offset with temporary cost -- with cost actions, right? That allowed us to have more or less flat gross margins quarter-to-quarter. Then we offset 30% of the lost revenue with SG&A cuts. Look at it that way.

Operator

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

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

Just using kind of the -- maybe this is like too sneaky or something. But using the percentage of sales for free cash flow getting to something in kind of the $6.4 billion range for annual sales, is that kind of around the right level?

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

We're going to get to a revenue number by hook or crook here. This is an interesting way to go about it. Look, I think that we've got line of sight on the percentage of revenue and on the conversion of net income. I expect -- we've exited Q2 with arguably inventory that supports the short and what we can see for Q3. So I would expect barring a real snapback in demand outside of what we've got baked into our numbers that we'll be liquidating inventory between now and the end of the year.

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

Right. I guess on the revenue, though, I'd guide...
Richard Joseph Tobin - Dover Corporation - President, CEO & Director

I know where you’re going. Look, I don’t think the number that you put out there is outlandish.

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

Okay. And when we think about kind of the third and the fourth quarter splits, I mean in ’18, they usually are kind of around each other. I would think this year, maybe with the cost, the structural costs coming in and a bit of that Belvac backlog perhaps in the fourth quarter, it sounds like things kind of took a step-up in June. So maybe you’re trending third quarter better. I mean how do we think about kind of the linearity for the third and the fourth quarter? Normally kind of seasonally, it looks like it’s roughly equal. But maybe this year, it’s a little lower in third and higher and fourth. How do we think about the linearity there on EPS?

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

Yes. You’ve got your finger on it. I mean, I think that we -- clearly, we have a tough comp in Q4 in DFS. So that will be levered to Q3. The swing factor is going to be where we are on the long-cycle side, which is driven by Belvac and Maag and then, to a certain extent, some other companies in there. I hope that we’re bringing a lot of that into Q3. And if that’s the case, then you’d have a sequentially better Q3, and we’re talking comp to comp here, than Q4. So what’s known is barring a -- and look, I hope it happens, but barring a real uptick in demand on EMV in Q4, right now, our expectation would be that we’re down in DFS Q-to-Q. But I think right now, based on June, we’re probably trending a little bit, on a comp basis, better Q3 and less so in Q4 right now.

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

Right. And then just lastly, just to be clear on this CapEx thing. You guys actually, I think raised the CapEx number from where you were last quarter. So it doesn’t look to me like there’s -- that’s kind of the free cash flow comp for next year. It’s not like you’re kind of squeezing tight there and that you’ve got a tougher comp on cash next year that this year’s cash obviously is inflated a bit by better working capital, but that we should think about some free cash flow growth next year despite kind of the unusual situation of this year where things are being squeezed a bit.

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

That’s fair.

Operator

Your next question comes from the line of Joe Ritchie of Goldman Sachs.

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

So Rich, you guys did provide like a lot of great color on Slide 9 on what your expectation is kind of for the rest of the year. But I guess just from a magnitude standpoint, can you help provide maybe just a little bit more color on how June actually trended from a magnitude perspective and whether that just persisted into July?
Richard Joseph Tobin - Dover Corporation - President, CEO & Director

Well, look, I mean, as I mentioned earlier, June was materially better than April, but April, I hope we don’t see again anytime soon. I mean April and May in certain of our businesses, which is a function -- a lot of this issue about the declining backlog. I mean we weren’t shipping anything and we weren’t getting any orders either. So when we were looking at this decision about reinstating guidance for the full year, I think that we’ve got a good playbook and in control in terms of the operating cost side, but it was almost entirely contingent upon how June was, how June manifested itself. And June came in both on a bounce back in the order rates and in terms of absolute profit that portends well for Q3. So Brad’s got the joke. If we can just keep having Junes from here on out, we’d probably be in good shape for the balance of the year. So that’s color I can give you on it.

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

Okay. Fair enough. And then -- and I guess just to follow up to that, I saw you guys lifted your buyback suspension. I guess how are you thinking about deploying capital at this point and whether you’re going to be more aggressive now that you’ve lifted the suspension?

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

Well, I mean, I think the hierarchy remains the same of organic investment, inorganic investment and then capital return. I think that the CapEx number that we’ve given you for the full year is relatively safe now. So it’s going to depend on inorganic investment. And if you go back to the comments, I think that the pipeline that we have right now is relatively encouraging, and I expect to be deploying inorganic capital in the second half. But having said that, if we’re unable to get the returns inorganically that we seek, then we’ll address capital return and not sit on a cash balance here.

Operator

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

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

Just one more here on the June 2 step, if I may. I’m sure June is typically better than May, any quarter, right? Good quarter or bad quarter. I mean can you just give us some kind of historical context of how significant the sequential lift was versus what would be normal?

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

You know what, I don’t know the answer to that question because we were -- everything that we look at around here is a function of relative declines. So -- which is -- which tells you a lot about 2020 in the COVID era. But I mean, I think that the rate of revenue decline in June was significantly less than we saw in April and May. But if I -- off the top of my head, Jeff, I get the guys are furiously going through pages here. Relative to seasonality, I don’t know. I think that Andrey is going to have to follow up with you on that one.

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

Okay. I’m on his calendar. I’ll do that with him.

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

We had some discussion here I think on earlier questions about temporary actions. I think it’s pretty clear how you’re going to attempt to manage those as they possibly come back. In that context, Rich, as we think about the other side of this valley and managing for growth on the other side,
what are you thinking on incrementals? Is there significant headwind from stuff coming back? Or can you kind of manage this kind of, I would guess, maybe 30% ZIP code incrementals on the way back out?

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

Other than bonus accruals, there’s really no overhang of deferral of costs that have to snap back. I think the big question -- I think there was a question earlier about it, and I think this applies not just to Dover, to everybody is everybody has reduced travel cost, right? Does it come back to ’19 levels as a percent of revenue or not, I mean the expectation there is absolutely not. I think that we’ve proven that we can run this business with less discretionary spending than we may have thought is necessary exiting ’19. So what the quantum of that is I think it’s a little bit too early to tell, but it will be reflected in whenever we give out guidance for ’21, for sure.

The rest of it -- look, at the end of the day, I think that we did a admirable job in managing furloughs and a variety of things. So I don’t expect that we’re going to run significant industrial friction with overtime or anything else in the second half. That’s my expectation. It won’t be perfect, but I don’t see that our incremental margins should have any kind of negative drag once we get to, hopefully soon, back to growth.

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

And just one last one, if I could. So on the M&A front, it sounds like you clearly have stuff in your sites now, which is a question of whether they -- you can get it across the finish line. Should we be thinking kind of the similar size of what -- some of these recent bolt-ons have been? Or is there some bigger stuff in the pipeline? And I’ll leave it there.

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

Sure. Actionable, it’s going to be similar size to what you’ve seen. There’s some bigger opportunities that are out there. The bigger the opportunity, the more competition, so returns get tighter. So we’ll see on that front. But I’m pretty confident on kind of the size that we’ve seen year-to-date, it’s just a question of can we close them or not in the second half.

Operator

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

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

Maybe just the first question around the imaging and ID segment. Fairly heavy decrementals in the first half given the gross margins and what happened with sales. I didn’t see too much color on the margin outlook on Slide 4 for that segment. So maybe help us understand how you see decrementals in the second half, how much narrower those should be in that segment versus what we saw in Q1 or Q2.

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

They should -- well, I mean let’s start from the beginning. In marking and coding, our margin -- which is substantially the bigger portion of that segment, our margins were flat. So all of the decremental margin in that segment was from textile printing. And if we go back and take a look at sequentially last year, textile printing weakened in the second half. So decrementals, as long as marking and coding can hold their margin performance, which we fully expect them to do, should be less in the second half just because of an easier comp.
Julian C.H. Mitchell - Barclays Bank PLC, Research Division - Research Analyst

I understand. And then switching maybe to the DEP segment. There had been a very strong multiyear period for the sort of waste handling piece. It’s somewhat of a niche market. So I just wondered if you could give us any context around what you’re thinking for the medium term there given what’s happened to or what will happen to municipal budgets and what kind of upgrade cycle you’ve already had there in recent years. Just trying to gauge how optimistic you are on that business beyond just the next quarter or so.

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

I think that the business management of that particular business has been on the front foot. The nonmunicipal business, if you go look at some of the bigger publicly traded operators, they’ve cut CapEx because of the profitability headwinds that they’ve had on their nonresidential business. We would consider that likely just to be deferred into 2021 as they manage their own cost structure. On the municipal side, we don’t see a lot of negative headwinds today. But considering the financing of cities and towns because of this COVID crisis, I think it’s a better-than-even bet that there’s some headwinds coming there. And because of that, I think the management is taking action on its cost structure to accommodate that today rather than waiting to the last minute.

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

And on the cost-out point, Rich, that you just made. Firm-wide at Dover, I think you had $20 million of restructuring charges in the first half in aggregate. Sorry if I missed it, but what’s the placeholder for the second half for that number?

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

We don’t -- look, we’re working on a variety of actions. I think we’ve got several footprint-related actions in the pipeline. Whether we’ll be able to action them in the second half or not, I’m not entirely sure. But it’s probably then a better-than-even bet that we will take some footprint-related charges in the second half, but I’ll give you the quantum when we get it all done.

Operator

Your next question comes from the line of Nigel Coe of Wolfe Research.

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

I’m kind of curious on -- obviously, you’ve elected not to give any revenue boundaries, which I completely understand. But I’d be curious how you see the rank ordering by segment in the second half of the year in terms of relative strength, rather weakness. I think in the past, Rich, you called out pumps and process as being the leader this year, which doesn’t seem unreasonable, but do you still see the similar ranking to how you viewed the world back in the first quarter?

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

Look, I don’t think in terms of what we expect relative to Q2, those nice arrows that Andrey put on the slide on Page 9 is kind of where we think the moving parts are relative to Q2. And then you’ve got moving parts because, quite frankly, you’ve had some businesses that have operated through the crisis relatively well. So we knew the Pumps & Process Solutions, because of its exposure on the biopharma side, was in a good position to kind of weather the storm as we got to the end of Q1, and it’s proven that so far. We expect it to hold profits flat for the full year is our expectation despite the headwind on the industrial pump side.
The marking and coding, quite frankly, has had an excellent performance, holding margins year-to-date. Look, the textile printing business, it’s just what it is when you have your end markets just absolutely blown up. We’re just going to have to wait this out. And that really will be a -- hopefully, a ‘21 story rather than a ‘20 story. So I don’t think that we think anything different today than we did at the end of Q1 in terms of the relative resilience of the individual pieces of the portfolio.

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

Okay. Very clear. And then cash is building quite nicely, about $650 million at the end of the quarter. You normally run somewhere between $3 million to $4 million depending on the quarter. But if you don’t deploy capital, which seems unlikely, you're going to be closer to $1 billion by year-end. So my question is, I'm not asking you to give us a number in terms of buyback, et cetera. But I would be curious how you view cash, the cash buffer going to ‘21. Where do you feel comfortable? Is that back to $300 million to $400 million? Or is it going to run higher going from here?

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

Yes. Look, I mean, I think you need to correct for dividend payments into the future, number one. And then after that, look, I think that we're not going to sit on a bunch of cash with negative yield on it, for sure. But the buffer will flex up and down based on the probability of inorganic investment at the end of the day, right? That's going to be the -- so if we're returning cash in Q4, it's because the pipeline that we see right now we don't have any short-term requirement to sit on the cash. If we happen to sit on it at the end of the year, I think that you can almost construe that as a positive signal because it means we may be building cash because probability weighting of the pipeline looks good.

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

Great. And then quickly on inventories. The bulk of the inventory build was raw materials or the majority of it was. Is that a conscious decision to buffer the supply chain? Or is that -- is this just one of those things?

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

It's purely on the backlog that we have going into Q3. So I would expect barring a snapback in revenue expectations for Q4 that we should come down in inventory, in finished goods inventory and industrial inventory, in Q3, some.

**Operator**

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

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

Can you hear me?

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

Yes. I can hear you.
Andrew Burris Obin - BofA Merrill Lynch, Research Division - MD
Yes. So a question on supply chains. Can you just talk about how much in terms of inefficiency in terms of supply chains have you seen in the second quarter, any way to quantify it? And how do you see supply chains evolving into the second half?

Richard Joseph Tobin - Dover Corporation - President, CEO & Director
It was not a material headwind in Q2. Now having said that, we weren’t making a lot in Q2. So the areas that we did have constraints, it wasn’t like we were under the gun in terms of production performance. But for the most part, our supply chains are relatively short considering the individual size of our businesses. So we had a few headwinds here and there, but it was not material from a cost point of view in Q2.

Andrew Burris Obin - BofA Merrill Lynch, Research Division - MD
Got you. So for the second half and going forward, no real changes in how you do business.

Richard Joseph Tobin - Dover Corporation - President, CEO & Director
Yes. Well, I guess it’s going to depend on the trajectory of all of the businesses because, look, at the end of the day, we’ve done relatively well on input costs. So as demand went down, will we be able to extract some benefits in raw material prices and the like, remains to be seen. I think we’re probably bought forward through Q3 and probably a little bit into Q4, but we got to watch the dynamics. If business activity snaps back, then we can expect oil prices to go up, so transportation costs to go up and the like. So we’ll keep an eye on it right now. But right now, on an input-cost basis, we’ve been a beneficiary I think in terms of input costs year-to-date.

Andrew Burris Obin - BofA Merrill Lynch, Research Division - MD
Got you. And just a follow-up question. In terms of Europe, I think there was some talk back in May about Europeans trying to catch up post-COVID. I think there was talk about VW being staying open in August or some talk about Italian staying open in August. Can you just give an update, anything different about how European businesses that you interact with will treat summer shutdown this year after COVID?

Richard Joseph Tobin - Dover Corporation - President, CEO & Director
You know what, Andrew, that’s a good question. I would have to get Andrey to get back to you. I think on consumer goods, we’ve seen decent performance, which manifests itself in the marking and coding business. I think in heat exchangers, we exited on a positive trajectory from where we were at the beginning of the quarter. So that’s kind of industrial applications, for lack of a better word. But I’d have to get back to you on the -- and look, and then we had certain businesses in the portfolio like automotive aftermarket that in April and May were absolutely very low levels of activity. So June relative to those 2 months, it’s improved, but I don’t think we need to get overly excited because that base is relatively low.

Operator
Your next question comes from the line of Josh Pokrzywinski of Morgan Stanley.

Joshua Charles Pokrzywinski - Morgan Stanley, Research Division - Equity Analyst
So we played a good amount of kind of outlook bingo here and filled in most of the squares. I guess I’ll just -- I’ll try one more, Rich, if you don’t mind. How much of the improvement in June, if you had to summarize, was customers reopening versus kind of improving? I mean just turning the lights on again versus really kind of ramping back up into any activity levels.
All right. You got me.

Bingo.

Yes.

Yes.

(inaudible) today. You got me. I admit (inaudible).

Look, I -- look, we had a lot of the businesses that were absolutely shut in April and May from an end-market point of view. So you have a reopening aspect to it. And that’s why we were -- when we were talking about the results at the end of Q1, we were basically saying, "Look, a lot of this hinges on whether we’re right about June or not in terms of the trajectory." And we ended up I guess calling it right, for a lack of a better word. But our portfolio, Josh, is so diverse. If any -- any answer to that question is just not going to be applicable across the entire portfolio. So -- which, quite frankly, is a strength to a certain extent.

And then second question, I know, obviously, shippable second half backlog is something you guys have talked a lot about today. What does that mean? Or how do you guys think about it as a plan for backlog at the end of the year? Is the plan basically saying, what, we’re going to be depleted and orders need to pick up to put us in kind of a normal position exiting the year? Or is the level of kind of backlog depletion that you’re contemplating kind of normal, for lack of a better term?

I think normal, for lack of a better -- in the longer-cycle business where it tends to be lumpy, the Maags of the world and the Belvacs of the world, they’re actually building a back -- a long-cycle backlog into 2021 today. On the short-cycle side, that is going to be more short cycle. So it depends on the trajectory between now and the end of the year, quite frankly. So we would expect certain businesses that have a seasonality to them like refrigeration that will deplete a bunch of the backlog between now and the end of September because generally speaking, retailers, they’ll be doing a lot of installs in Q4 around Christmas time. But now we’ll see if that’s -- if the dynamics change this year. So on the longer-cycle businesses, I think right now the trajectory is good as, as we deplete, we’re building into 2021. On the short-cycle ones, I guess it depends on when we get to the end of Q3 and what the outlook for revenue is to Q4, but I don’t see any anomalies in there.

Got it. Yes. I just wanted to make sure that nothing about some of the backlog conversions came at the expense of ’21. It sounds like that’s not the case. So good to hear.
Operator

Our final question will come from the line of Deane Dray of RBC Capital Markets.

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

Just a follow-up on the M&A outlook for the second half. And Rich, you talked about if it meets your return requirements but typically, in a downturn, there needs to be a process for seller valuation expectations to be reset. Do you think that's happened already?

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

Not as much as we'd like, but it is happening, I think.

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

Was that -- is that based upon books that are getting circulated? Just how much is...

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

Yes. I mean based on books that are being circulated and whispered numbers about expectation, it looks like it's better than it was clearly in the second half of '19, but you still have this notion that the public equity markets are trading quite well. And then so we look at a lot of private companies because of the market segment that we're in. And then there's this well, I want because of trading multiples that I see in the public equity markets. But that's -- that never goes away, but it's improved some. It's not improved greatly, but it's improved some.

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

Okay. That's helpful. And then on the free cash flow for the second half and considering the strength of your free cash flow conversion this quarter. If you're liquidating inventory, wouldn't we expect to see some really strong free cash flow conversions in the second half?

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

Well, I mean if you look historically, we generate a significant proportion of our full year cash flow in Q4, which we would expect but with the caveat of we expect to draw down inventories quite a bit this year in the second half just because of the lower revenue number. Hopefully, if demand improves in Q4, we may have to reverse that. But my expectation is, is that the seasonality will remain constant, but will probably not proportionally the way it's been in the past when we've been growing the top line where it's been highly levered to Q4. It's probably a little bit more evenly balanced this year.

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

Yes.

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

Got it. And then just last one. On the pumps business, can you clarify whether the business is exposed to pharma, biopharma, anything COVID-related in your sanitary pumps?
Richard Joseph Tobin - Dover Corporation - President, CEO & Director

It is exposed to biopharma, a material piece of it. And that's what has been driving the growth. And we are going to do an Investor Day around that particular business sometime when, Andrey, late August, early September, TBD, where we'll give you more color on it.

Operator

That concludes our question-and-answer period and Dover's Second Quarter 2020 Earnings Conference Call. You may now disconnect your lines at this time and have a wonderful day.