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DOV - Q4 2016 Dover Corp Earnings Call

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OVERVIEW:

Co. reported 4Q16 revenues of $1.8b and EPS of $1.03. Expects 2017 total revenue growth to be 10-12% and 2017 EPS to be $3.40-3.60.

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PRESENTATION

Operator

Good morning and welcome to the fourth-quarter 2016 Dover earnings conference call. With us today our Bob Livingston, President and Chief Executive Officer; Brad Cerepak, Senior Vice President and CFO, and Paul Goldberg, Vice President of Investor Relations.

(Operator Instructions)

As a reminder, ladies and gentlemen, this conference call is being recorded.

(Operator Instructions)

I would now like to turn the call over to Mr. Paul Goldberg. Mr. Goldberg, please go ahead.

Paul Goldberg - *Dover Corporation - VP of IR*

Thank you, Kristin.

Good morning and welcome to Dover's fourth-quarter earnings call. With me today are Bob Livingston and Brad Cerepak. Today's call will begin with some comments from Bob and Brad on Dover's fourth-quarter operating and financial performance and follow with our 2017 outlook. We will then open up the call for questions.

As a courtesy, we kindly ask that you limit yourself to one question with a follow-up. Please note that our current earnings release, investor supplement, and associated presentation can be found on our website, dovercorporation.com. This call will be available for playback through

February 9 and the audio portion of this call will be archived on our website for three months. The replay telephone number is (800) 585-8367. When accessing the playback you will need to supply the following access code: 49616212.

Before we get started, I'd like to remind everyone that our comments today, which are intended to supplement your understanding of Dover, may contain certain forward-looking statements that are inherently subject to uncertainties. We caution everyone to be guided in their analysis of Dover by referring to our Form 10-K for a list of factors that could cause our results to differ from those anticipated in any such forward-looking statement. Also, we undertake no obligation to publicly update or revise any forward-looking statements except as required by law. We would also direct your attention to our website, where considerably more information can be found.

And with that, I'd like to turn the call over to Bob.

Bob Livingston - *Dover Corporation - President and CEO*

Thanks, Paul. Good morning, everyone, and thank you for joining us for this morning's conference call.

Overall, I was pleased with our fourth-quarter business activity and results. Among the highlights in the quarter were a continuing recovery in our shorter cycle drilling and artificial lift markets, along with strong results in our printing and identification platform. We also saw solid activity in bearings and compression, as well as our petrochemical and polymer markets.

From a geographic perspective, organic growth was mixed. Our US activity, excluding energy, was flat year over year; our European and China activity improved year over year and sequentially. Energy performed very well in the quarter and modestly exceeded expectations. Revenue was up 7% sequentially, largely driven by early cycle upstream applications. Our bearings and compression businesses also had a very good quarter driven by a positive customer mix. Segment margin was 10.5% and EBITDA margin returned to over 20%. Engineered Systems organic growth of 1% was driven by another strong quarter in printing and identification, which had 5% growth.

In the industrial platform, organic revenue declined slightly as activity slowed in the second half of the year at Environmental Solutions. Fluids posted 36% revenue growth, driven by acquisitions. Organically, fluids was flat. Within this result, strong activity in our petrochemical and polymer as well as our hygienic and pharma markets was offset by continued softness in our longer cycle oil and gas markets. Refrigeration and Food Equipment revenue declined 1% organically, principally driven by tough comps in canned shaping equipment.

Core margin performance was below expectations at Hillphoenix, due to product mix and production challenges in case manufacturing. I am confident the changes we're implementing will result in improvements in this business. During the quarter, we closed Rav and Wayne, and both are off to a great start. We also closed on the sale of a business not considered core to our growth strategies.

Now looking forward, within energy, we are encouraged by the recovery in the North American rig count and oil prices during the second half of 2016. We see strong growth in 2017 and have developed our guidance based on an average US rig count of 680 to 700 and an average WTI price of $55. Current market sentiment is a bit more bullish than our assumptions, thus our guidance may turn out to be conservative. In Engineered Systems we expect our printing and ID platform to continue its strong record of performance, driven by increased equipment sales and very consistent consumable revenue in our marking and coating business. Also a strong contribution from Rav will complement modest but mixed organic growth in our industrial platform.

Fluids' strong growth will be driven by acquisitions, primarily Wayne, from which we expect a significant contribution to EPS. We also expect to see solid petrochemical and polymer as well as hygienic and pharma markets. Our longer cycle oil and gas markets are expected to remain soft for the bulk of the year, especially within transport markets. Finally, within Refrigeration and Food Equipment, we expect solid activity in Food Equipment, glass doors, and specialty refrigeration cases. At this time, we expect our standard case business to be modestly down on reduced activity at a few big-box retailers. We are very focused on margin and expect it to be better as customer and product mix and manufacturing all see improvements. Order activity is showing strength early in 2017.

With that, I'd like to turn it over to Brad.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Thanks, Bob. Good morning, everyone.

Let's start on slide 3 of our presentation deck. Today we reported fourth-quarter revenue of $1.8 billion, an increase of 5%. Within this result, growth from acquisitions of 11% more than offset an organic revenue decline of 2% and a 4% impact from dispositions and FX. EPS was $1.03, which included a disposition gain of $0.36, a product recall charge of $0.09, and discrete tax benefits of $0.05. For the full year, EPS was $3.25; the earnings bridge can be found in the appendix of our presentation deck. Segment margin for the quarter was 15.8%; adjusting for the previously mentioned special items and restructuring, margin was 12.8%. This result was below last year, largely driven by lower organic revenue and the impact of acquisitions.

Bookings increased 7% from the prior year to $1.7 billion. On our organic basis, bookings declined 1%. Acquisition growth of 12% more than offset the combined impact of reduced oil and gas markets, dispositions, and FX. Organic bookings in Engineered Systems grew 2%. Refrigeration and Food Equipment declined 2%, while fluids and energy were down 3% and 4%, respectively. Total Company book-to-bill finished at 0.98. Our overall backlog increased 8, to $1.1 billion. On an organic basis backlog declined 1%. Free cash flow was $240 million or 14% of revenue. For the full year we generated nearly $700 million of free cash flow or 10.3% of revenue.

Now let's turn to slide 4. Engineered Systems organic revenue increased 1%, reflecting solid growth in printing and identification, partially offset by soft industrial markets. Fluids organic revenue was essentially flat. Refrigeration and Food Equipment declined 1%, driven by tough comps in canned shaping equipment. Energy organic revenue was down 8%. As seen on the chart, acquisition growth in the quarter was most prevalent at fluids and engineered systems at 37% and 8%, respectively.

Now on slide 5. Energy revenue of $293 million decreased 9%; on a sequential basis, revenue increased 7%. Earnings were $31 million and segment margin was10.5% including restructuring costs of $1 million. These results exceeded our expectations and reflected very strong incremental margin. Bookings of $300 million were down 5% year over year, but more importantly showed 11% sequential improvement. These booking trends, along with continued to rig count additions set us up for a strong start to the year. Book-to-bill finished at 1.02. Of note, December book-to-bill was 1.09.

Turning to slide 6, Engineered Systems revenue of $626 million was up 5% overall. Included in this result is organic growth of 1% and net acquisition growth of 5%, slightly offset by FX. Earnings of $97 million increased 8%, principally reflecting strong performance in printing and identification and the benefits of productivity. Our printing and identification platform revenue of $268 million increased 4%. Organic revenue was up 5%, reflecting solid global marking and coating markets and strong digital printing equipment activity. In the industrial platform, revenue increased 5% to $374 million. This result included net acquisition growth of 7%, and an organic decline of 1%. The organic decline reflected slower activity at Environmental Solutions.

Margin was 15.5%, a 60 basis point improvement primarily reflecting the benefits of productivity programs. Excluding acquisitions, margin was 17.3%, up 220 basis points on a comparative basis. Bookings of $643 million were up 6% overall, including organic bookings growth of 2% and growth from net acquisitions of 5%. Organically, printing and identification grew 8%, while industrials declined 2%. Book-to-bill for printing identification was 1.01, industrial book-to-bill was 1.04; overall our book-to-bill was 1.03.

Now let's move to slide 7. Fluids revenue increased 36% to $483 million. Revenue performance reflects 37% growth from acquisitions, partially offset by a 1% FX impact. Organic growth was essentially flat. This result primarily reflects strong shipments to petrochemical and polymer customers, and continued strong results in pharma and hygienic markets, offset by weak longer-cycle oil and gas markets, especially in transport. Earnings decreased 44%, to $35 million, excluding the product recall charge and restructuring, earnings improved modestly.

Margin in the quarter was 7.2%. Excluding the product recall charge and restructuring, margin was 13.6%. Of note, core margin remained very solid at over 18%, which further adjusts for the impact of acquisitions and related deal costs. Bookings were $457 million, an increase of 42%. This result principally reflects the impact of acquisitions. On an organic basis, bookings declined 3%. Book-to-bill was 0.95.

Now let's turn to slide 8. Refrigeration and Food Equipments revenue of $376 million included an organic revenue decline of 1%. The revenue decline was largely driven by project timing in our can shaping business. Earnings of $118 million included a disposition gain of $85 million. Adjusting for this gain, and restructuring, earnings were $34 million, down 30% from the prior year, and adjusted margin was 9%. Production and efficiencies of about $7 million at Hillphoenix accounted for the majority of this decline. Bookings of $337 million decreased 2% organically, principally reflecting soft order activity by a few big-box retailers. Book-to-bill was 0.89.

Let's move to the overview on slide 9. Let me cover some highlights. Corporate expense was $32 million, higher than our forecast, and includes a settlement of approximately $3 million. Net interest expense was $33 million, largely in line with expectations. Our fourth-quarter tax rate was 25.4%. CapEx was $49 million in the quarter.

Moving on to slide 10 which shows our 2017 guidance. To start, let me say our revenue guidance is unchanged from the forecast we shared at our investor meeting just two weeks ago. We expect total revenue to increase 10% to 12% including organic revenue growth of 3% to 5%. We also expect acquisitions will add approximately 10% growth, partially offset by completed dispositions and FX. From a segment perspective, energy is expected to grow 13% to 16% organically, driven by improving upstream North American oil and gas fundamentals. Engineered Systems organic growth is anticipated to be 1% to 3%, driven by very solid printing and identification markets. We expect both Fluids and Refrigeration of Food Equipment to post flat to 2% organic growth.

Corporate expense is anticipated to be around $125 million, up about $12 million over last year, reflecting a comp reset and planned investments as we further implement Dover business services across the Company. Net interest expense is up modestly over 2016 on the funding of the Wayne deal. We forecast the full-year normalized tax rate to be about 28%, CapEx should be around 2.4% of revenue, and we expect to generate free cash flow at 11% of revenue. Lastly, we expect segment margin to be around 13.7% at the midpoint of our guidance.

Turning to the 2017 bridge on slide 11. Let's start with 2016 adjusted EPS of $2.85. We expect the year-over-year impact of lower restructuring costs in 2017 to be $0.08 to $0.10. Performance, including changes in volume, productivity pricing, and restructuring benefits will add $0.81 to $0.95 to earnings. Increases in investment and compensation will impact earnings $0.15 to $0.13. Growth investments comprise about two thirds of this total. Lastly, the combined impact of interest, corporate expense, and the tax rate will be a $0.19 to $0.17 headwind. In total, we expected 2017 EPS to be in the range of $3.40 to $3.60, at the midpoint of our guidance. This represents a 23% increase over the adjusted prior year.

With that, let me turn the call back over to Bob.

Bob Livingston - *Dover Corporation - President and CEO*

Thanks, Brad.

I am very optimistic about 2017 and believe we are well-positioned to take advantage of the many opportunities in front of us. Within energy, we see improving US oil and gas markets driving growth in our drilling, artificial lift, and automation businesses, which represent about two-thirds of this segment's revenue. For this segment we are expecting strong organic growth in 2017. Within Engineered Systems we see adoption rates of digital printing continuing to grow. In our marking and coding business, market conditions remain favorable and we expect continued strong execution. Additionally, our recent Rav acquisition will be a significant contributor to growth and we are excited to become an even stronger partner with our customers in the global vehicle service market.

We also expect our core industrial businesses to post modest organic growth. In Fluids, 2017 strong growth will be driven by recent acquisitions, most notably Wayne. We have a great management team in place who are fully focused on the EMB opportunity and capturing significant synergies. Modest organic growth will largely be driven by strong hygienic and pharma markets and improved customer activity in our petrochemical and polymer and industrial markets. Lastly, in Refrigeration and Food Equipment, recent strong bookings in canned shaping equipment has set Food Equipment up for an improved 2017.

We also expect another solid year for glass doors and specialty refrigeration cases. Also encouraging is the fact that we are well booked in refrigeration cases for the first quarter. And I fully expect margin to expand in the second half of the year, as our improvement initiatives take hold. As we begin the year, our markets are largely constructive, and I am confident we will execute well and deliver on our 2017 plans.

In closing, I'd like to thank our entire Dover team for staying focused on our customers. Now, Paul, we will take some questions.

Paul Goldberg - *Dover Corporation - VP of IR*

Thanks. Before we open up the line to questions I'd just again like to remind you, as a courtesy, if you can ask one question with a follow-up, we'll be able to get more questions and we have over 20 people in queue. So with that, Kristin, let's take the first question.

QUESTIONS AND ANSWERS

Operator

Thank you. Jeffrey Sprague, Vertical Research Partners.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Thank you. Good morning, everyone.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Jeff.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Hey, I've have got two unrelated questions if you can take them. First, just on Wayne itself, Bob, now that you've got it closed, can you just share a little bit kind of -- its performance the last three to six months, the trend in the business into the closed so to speak, and is there any kind of overhang or anything to be thinking about in the first half as you digest it?

Bob Livingston - *Dover Corporation - President and CEO*

So there, Jeff, I'll give you a comment on the second half of 2016, because that's really when we started tracking their performance on a fairly close basis. The -- as we have communicated and as we expected, the retail fuel and market does build quarter-to-quarter sequentially through the year. We saw that happen at Wayne.

I would say for their second half of the year revenue plan they were perhaps -- they perhaps slightly exceeded it. They actually had a strong -- a pretty solid and strong December, our first month of ownership with them. So we were quite pleased with the performance of the business in the second half of the year.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

I'd like --

Bob Livingston - *Dover Corporation - President and CEO*

I'll actually share this with you, for those who may be interested, if you are trying to fill out your models. I think the revenue we booked under what, the three or three and a half weeks of ownership in December, Jeff, I think it was approaching $50 million.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Okay. Great.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Very strong margin but you know, dilutive to the results of Dover because of -- to your question on overhang, we had some expenses and costs in the fourth quarter but, Jeff, as we go forward we are going to continue to see charges through the P&L related to Wayne in capturing the synergy benefits.

I would say, you know, those amount to about $9 million to $10 million or so in 2017 and not having all the data in front of me I'd say they're pretty evenly spread. I don't see any big impacts to the first quarter on Wayne related to those synergy costs.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

We obviously don't have any idea of like -- what Wayne's plan looks like versus history or anything, but would you characterize the performance as up versus 2015? Do you have visibility?

Bob Livingston - *Dover Corporation - President and CEO*

We actually do have. I don't have the exact data but I do know it was up in 2016 over 2015, Jeff.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Great. Thanks. Could you just quickly, and I'll get off, on price for energy, I think you've said you weren't planning it. Baker out there this morning saying that people are begging for prices to be held flat, so to speak. Do think there will be upward pressure on price for you, price realization? Is that starting to happen in your business yet?

Bob Livingston - *Dover Corporation - President and CEO*

Upward pressure on price -- are you are asking of the customers are going to encourage us to raise our prices? I don't think that's going to happen.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

No, that are you going to despite their discouragement raise it anyhow?

Bob Livingston - *Dover Corporation - President and CEO*

I -- you could actually see that very judiciously in the second half of the year. I would not expect to see anything of note to occur in the first half of the year, Jeff, and we're not planning on any price increases at all for 2017.

I will point out that we did end 2016 on a price down number of -- I think it ended up right at 2% of revenue for this segment, Brad, am I correct? Which is what we had been guiding all year in, and so I feel comfortable with, I call it, the pricing part of the energy plan for 2017 and maybe we see a little bit of lift in the second half, Jeff.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Great. Thank you very much.

Bob Livingston - *Dover Corporation - President and CEO*

Yes.

Operator

Shannon O'Callaghan, UBS.

Shannon O'Callaghan - *UBS - Analyst*

Good morning, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Shannon.

Shannon O'Callaghan - *UBS - Analyst*

Bob, maybe you could put a little more context on the comment that the energy markets are little more optimistic than what you've baked in. I mean you've talked about the 1.09 book-to-bill in December, maybe just a little context on where that stands versus what you would normally see end of December, and also the bearings and compression business in there actually turned this quarter, too. Is that going to continue or is that kind of a one-off?

Bob Livingston - *Dover Corporation - President and CEO*

Okay. So let me give the answer to the question that's probably a shorter response, and that's bearings and compression. The folks there had an outstanding fourth quarter, but I would also tell you it was just about as expected.

We had some project shipments scheduled for the fourth quarter. The team did a great job of executing. They delivered good margins on that, but it was some project activity, Shannon. We look into 2017 for bearings and compression. We've got modest organic growth in bearings and compression.

It is a bit lumpy. We're not going to see sequential growth in B&C from the fourth quarter to the first quarter simply because of the strong project shipments in the fourth quarter but we will see growth in 2017. Comment on, let's call it, the upstream activity. Look, the headline number we all watch, right, actually I would say two headline numbers that we watch, and one of them we can see weekly, is the rig count deployment, and so we all know what the trend line has been. The -- we were -- nobody was more pleased to see the rig count increase that was posted last week. I think it was 35 or 37 units. Brad?

Brad Cerepak - *Dover Corporation - SVP and CFO*

35, yes.

Bob Livingston - *Dover Corporation - President and CEO*

As we start here in January, maybe our recount assumption is a bit conservative. That said, Shannon, don't look at rig count as being the leading indicator for the entire segment.

It is a very, very good indicator for our drilling activity and, in fact, I would tell you that in 2016, our drilling activity increased perhaps even a little bit stronger than we saw in the rate of change with respect to rig count in the second half of the year. I think some of that was a little bit of restocking. But in 2017, I would expect our drilling activity to pretty highly correlate with rig count. That's not quite true with automation and artificial lift.

The significant increase in CapEx spending that we've seen with customers in the second half of 2016, and I suspect the lion's share of some of the increased CapEx spending that we'll see in the first at least in the first quarter of 2017, is highly weighted to drilling. We are seeing increases in well completions. But it is not nearly at the rate that we are seeing with rig count increases.

We do expect well completion activity to pick up during the year, but the rate of change in the first half -- or second half of last year was nowhere near the rate of change we saw in rig count. I hope that gives you some color.

Shannon O'Callaghan - *UBS - Analyst*

Yes. That's great, Bob, thanks. And just one quick follow up on the sequential margin there, it was very strong leverage sequentially but even adjusting for restructuring Q3 to Q4, anything in particular I mean other than was that mainly the fact that the drilling business had a strong quarter? Were there any other positive mix factors to consider in for Q4 for energy?

Bob Livingston - *Dover Corporation - President and CEO*

Well, you're right about the drilling business having a very strong fourth quarter, but again I'll give a shout out to the guys at bearings and compression. The revenue increased sequentially from the third quarter to fourth quarter, it ended there were pretty good margins on that business.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Across the board in energy they were sequentially up as you know, and the margin conversion was quite good. In fact, going into 2017, sequentially, we would expect very strong margin conversion and year-over-year margin conversion and energy in excess of 40%.

Shannon O'Callaghan - *UBS - Analyst*

Great. Thanks, guys.

Operator

Deane Dray, RBC Capital.

Andrew Krill - *RBC Capital Markets - Analyst*

Good morning, this is Andrew Krill on for Dean. I want to see if you can give some more color on the declines you've been seeing in Environmental Solutions, and I think how long you expect this to persist and what might be in guidance?

Bob Livingston - *Dover Corporation - President and CEO*

Okay. So the second half -- I'm not sure I can separate the fourth quarter from the second half on that. The second half activity was probably down, gosh, it could have been as much as 5% or 6% versus the first half of 2016, just within Environmental Solutions, and we actually weren't expecting that. We were expecting a little bit of a falloff in the fourth quarter, but as we came to the second half of year we weren't expecting that falloff in the third quarter.

We see the softness continuing in Environmental Solutions through the first quarter. We think by the time we get to mid part of the second quarter that the customer buying activity returns and we'll see a much stronger revenue and earnings progression in that business and our guide reflects that.

Andrew Krill - *RBC Capital Markets - Analyst*

Okay and is there a specific vertical that is causing this ongoing kind of weakness?

Bob Livingston - *Dover Corporation - President and CEO*

No. This is a fairly defined vertical. It's refuse trucks.

Andrew Krill - *RBC Capital Markets - Analyst*

Got it. And then just as a follow-up, can you update us, I think, on energy? There's a pretty steep margin kind of improvement as the year progressed, and just want to see if that's on track as you kind of round out January?

Bob Livingston - *Dover Corporation - President and CEO*

Well, I don't have January closed yet, but as I -- the order rates not just in energy, I would say this for all that's on the call. The order rates here in January, in general, largely across Dover are coming in a little bit stronger than we had anticipated for January.

And specific -- your specific question about conversion and energy, I think Brad answered that a few minutes ago, we're expecting fairly healthy incremental margins in energy at a little bit better than 40% and we feel pretty confident with that.

Andrew Krill - *RBC Capital Markets - Analyst*

Okay. Great. Thank you very much.

Operator

Andrew Obin, Bank of America.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Yes. Good morning.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Andrew.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Just, I'll ask question [on energy], I apologize. Can you comment on exit margins in December?

Bob Livingston - *Dover Corporation - President and CEO*

Okay. I'm going to take a guess, I know Brad is going to correct me, but I think our operating margins and this would've been no adjustments -- whatever restructuring charges we had in December would've been included in this. But I think our operating margins in December were like 11.1% They were a little bit better than 11%.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes.

Bob Livingston - *Dover Corporation - President and CEO*

Okay?

Andrew Obin - *BofA Merrill Lynch - Analyst*

And that's with adjustments.

Bob Livingston - *Dover Corporation - President and CEO*

I'm sorry. Repeat that.

Andrew Obin - *BofA Merrill Lynch - Analyst*

That was with the adjustments.

Bob Livingston - *Dover Corporation - President and CEO*

If there were any.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Okay.

Bob Livingston - *Dover Corporation - President and CEO*

If there were any restructuring charges the margin I'm giving you includes those restructuring charges. I just don't recall what the restructuring charges were in the month.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes. In the month.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Appreciate it.

Bob Livingston - *Dover Corporation - President and CEO*

We had [$]1 million for the quarter.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Got you. And just to follow up on Wayne, could you just talk what it is you are seeing in the channel in terms of larger customers putting for retrofits versus readers? What are you hearing because we are sort of hearing conflicting messages from the channel. On one hand you have sort of big brands encouraging their retailers to do a full upgrade, at the same time you do have the allegation of the cycle.

Bob Livingston - *Dover Corporation - President and CEO*

Well, I'm not sure that I -- that we are hearing much different from that. It does vary from customer to customer, and I'm referring to, you said specifically the larger accounts.

The -- it's going to be a bit different, but as a general statement, I think what we are generally hearing is that if the dispenser is eight years or older, the dispenser on the island, if it's been in the field eight years or longer I think the operators are being given strong encouragement by the brand owner to replace the dispenser in its entirety.

If it's less than eight years, then we are seeing -- we are simply seeing the up fit -- or the upgrade kit being sold.

Andrew Obin - *BofA Merrill Lynch - Analyst*

And what --

Bob Livingston - *Dover Corporation - President and CEO*

I'm actually sure that's -- I don't think that's much different than what we've been hearing over the last three or four months either.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Got you, and what share of the install base is eight years or older?

Bob Livingston - *Dover Corporation - President and CEO*

Pardon?

Andrew Obin - *BofA Merrill Lynch - Analyst*

What share of the install base is --

Bob Livingston - *Dover Corporation - President and CEO*

I don't have that data.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Okay. I will take it off-line. Thank you so much.

Bob Livingston - *Dover Corporation - President and CEO*

Thank you.

Operator

Steven Winoker, Bernstein.

Steven Winoker - *Sanford C. Bernstein & Co. - Analyst*

Thanks and good morning, all.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Steven.

Steven Winoker - *Sanford C. Bernstein & Co. - Analyst*

Hey, just like to start some of the peer companies have talked about customer pull through and budget flushes at the end of -- through December. Maybe outside of energy, which you've covered pretty well in your other businesses. Did you see any signs, evidence, discussion that, that might be happening?

Bob Livingston - *Dover Corporation - President and CEO*

No. I mean, we had strong order rates in December but I wouldn't -- I don't think we -- that's just not part of our portfolio makeup. That's -- I don't think we see that.

Steven Winoker - *Sanford C. Bernstein & Co. - Analyst*

Okay and then on margins, both in fluids and refrigeration, and Hillphoenix, outside of the one timers, obviously, still obviously we have productivity issues in refrigeration. But maybe talk about just some of the activities there from an operational basis, from a supply chain plant basis, to what extent do you think you'll start to see better leverage incrementals performance?

Bob Livingston - *Dover Corporation - President and CEO*

Okay. So I think we may have shared this, maybe on our October call. I think I shared with you that our -- I'll call it our production variances within Hillphoenix, that we sort of took it on the chin with in the third quarter were about $7 million. I think -- okay. (Multiple speakers)

And I think, in the fourth quarter it was a little less but it wasn't -- I mean, it was still -- I would still say it was too high. It was in the $5 million to $6 million range. One of the key metrics, and there are several, but one of the key metrics, one of the key KPI's that we manage to within this business is the production hours per case, and we've been making slow and steady progress on that KPI for the last four or five months.

I'd like to think the trend we're seeing here in the early part of the year here so far in January is one that we continue with, but we have seen a rather significant improvement in our KPI here in January on production hours per case.

Steven Winoker - *Sanford C. Bernstein & Co. - Analyst*

Okay.

Bob Livingston - *Dover Corporation - President and CEO*

And on the -- we're not -- I've told you, our guide is that the second half of the year is when we're going to start to see some improvements in margins within the segment, driven by the improvement in margins within Hillphoenix, and don't expect it any sooner than that.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes.

Steven Winoker - *Sanford C. Bernstein & Co. - Analyst*

Okay. And how about --

Bob Livingston - *Dover Corporation - President and CEO*

We'll try to deliver it sooner, but don't expect it any sooner.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Maybe I can add to that a little bit. And maybe just pick up where Bob left off on our margin profile.

And what I would add to that is as we progress through the year, we see the first quarter margin really setting up lower year over year, given the refrigeration and some other things, including Tokheim becoming what I call core now. So I'm talking core margins, first quarter being below the prior year but then progressively improving throughout the year where we see our core margin expanding for the year by roughly 20 basis points year over year being impacted again by what we've said already, by investment levels that we are making.

So the progression for the year really coming off of last year is what I would say modestly down margins in the first quarter, expanding margins throughout the rest of the year. And part of that's our profile --

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Bob Livingston - *Dover Corporation - President and CEO*

Part of it's the profile, so if I were to add to that, if you were -- if you follow -- if you look at the top end of our guide and look at the revenue number, the second half of the year is up about $250 million, am I right on that? Up about $250 million over the first half. The two -- Brad's comment on this, the two drivers of this is the sequential build through the year within our energy segment and the, I call it the market profile within retail fueling, both of which we believe will be normal and ordinary in 2017.

And the pressure we're going to feel in the first quarter as Brad related on margins on a year-over-year comp, it's real and we have it in our guide that way. But we will see a significant change in business results in the second quarter and slight improvement going into the third quarter and we'll again, because of refrigeration, we'll see a little bit of a seasonal roll off in the fourth quarter. But I think you really need to look at our profile again because the energy model for this year of sequential improvements through the year and the impact that retail fueling is having on the Dover profile, I call it the quarterly waterfall, it is -- it does create a little bit different profile for Dover in 2017.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes. And coupled with, by the way, let's not forget that we have gains on dispositions in first-quarter and in 2016.

Bob Livingston - *Dover Corporation - President and CEO*

In 2016.

Brad Cerepak - *Dover Corporation - SVP and CFO*

And in the fourth quarter now, so the way I think about it first quarter 2016 was $0.52 and with margin, with the margin that we're talking about, we're not giving guidance for the first quarter but I would tell you we've seen modest improvement off of that $0.52, and then --

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Bob Livingston - *Dover Corporation - President and CEO*

Not significant improvement.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Not significant but more significant than as we progress through the year, so hopefully that gives you an insight on our margin expectations and what's driving the top line to more of a back half versus first half growth rate.

Steven Winoker - *Sanford C. Bernstein & Co. - Analyst*

Very helpful. Thank you.

Operator

Nigel Coe, Morgan Stanley.

Nigel Coe - *Morgan Stanley - Analyst*

Thanks. Good morning, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Nigel.

Nigel Coe - *Morgan Stanley - Analyst*

So copious color there on margins. I'm a little bit slow this morning, so just want to clarify maybe Brad or Bob, so you looking at Q1 EPS of somewhere between 55 and 60 -- is that the right thing?

Brad Cerepak - *Dover Corporation - SVP and CFO*

We're not going to give guidance.

Bob Livingston - *Dover Corporation - President and CEO*

We're not going to argue with you Nigel.

Nigel Coe - *Morgan Stanley - Analyst*

Not going to argue? Okay.

Bob Livingston - *Dover Corporation - President and CEO*

Okay. Well, he's not arguing.

Nigel Coe - *Morgan Stanley - Analyst*

So switching back to energy, just wanted to get into some of the two smaller segments there. Automation still down significantly, and I think we all view that as a bit more of a structural [grower] longer-term. I'm just wondering what kind of perspective are you hearing from customers on the need or the want to [admit] their wealth and typically how long into recovery is a before we see automation spending picking up?

Bob Livingston - *Dover Corporation - President and CEO*

I think we're starting to see it now, Nigel. I actually was pretty pleased with the activity we saw in the fourth quarter within automation.

In fact, I -- if I'm not mistaken, automation growth in the fourth quarter actually may have been slightly better than we saw in artificial lift; so I was really pleased with the activity and the fourth quarter. But more importantly, the question you ask is, what are the customers -- how are we engaging with customers and what are they saying. And we see this as being a significant opportunity for further growth, not only in 2017 but into 2018.

And I like the margin profile of this business. I like the level of customer engagement we have in the business and I think you'll see us post some good growth here in 2017.

Nigel Coe - *Morgan Stanley - Analyst*

Okay. That's helpful. And then, digging into bearings and compressions, a lot stronger than we'd expected, but obviously not [to] your plan. Just continue to remind us, what is driving that business? Is it more of the OE turbines? Specific (inaudible) market?

Bob Livingston - *Dover Corporation - President and CEO*

No, I just -- Nigel, I would tell you the fourth quarter, we did within bearings and compression, we did see one of our major OEMs return with some fairly strong demand that we were able to respond to rather quickly in the fourth quarter. We also had some other project type of business in our bearings business, in our bearings portfolio but the significant part of that was with OE activity.

Nigel Coe - *Morgan Stanley - Analyst*

Okay. That's very helpful. Thanks, guys.

Operator

Steve Tusa, JPMorgan.

Steve Tusa - *JPMorgan - Analyst*

Hey, guys. Good morning.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Steve.

Steve Tusa - *JPMorgan - Analyst*

The -- we don't have all the details from the cash flow statement, but it looks like there was in the fourth quarter the net change in assets and liabilities was a pretty big number. It was like $140 million or something like that, backing out the first nine months.

And anything going on there? Is that just -- what part of the business was that in, working capital wise? Was it something else, like a tax dynamic?

Brad Cerepak - *Dover Corporation - SVP and CFO*

Well, look, I think my reaction to it not having the date in front of me is that we did complete several acquisitions in the fourth quarter. You're seeing that impact on the balance sheet for sure.

And so, not able to give you the date and net of that or the core working capital. You have to follow up with Paul on it in a little bit more detail, but nothing fundamentally different with respect to the core.

I'd say, if anything, we saw based on the trends to the back half of the fourth quarter, that our working capital grew a little bit, Steve. So we did -- we were a little bit lower on our guide on free cash flow, and I would say that, that's on the balance sheet but it's not a big number.

Bob Livingston - *Dover Corporation - President and CEO*

But the other color I'd give you, Steve, on that is December inventory build we actually had December increase in inventory and that's pretty unusual for us. But the -- it was in response to stronger order activity we saw in November and December, our order rates built through the quarter excluding refrigeration, our order rates pretty much across the board within Dover built through the quarter. We typically don't see an inventory build in December; we experienced a little bit of that this year.

Steve Tusa - *JPMorgan - Analyst*

Right, and I guess that's another follow-up cash question on CapEx. You guys were at a relatively low level versus DNA. You guys have obviously done a couple of big deals, so you may have enough capacity and historically your CapEx has kind of moved up with sales. You feel like it's kind of at the low end of the range right now.

Would you expected that to continue to kind of inch up as a percentage of revenues over the next couple of years if we get into recovery mode, or you have plenty of capacity to kind of observe any growth you see out there?

Bob Livingston - *Dover Corporation - President and CEO*

Look, I think the guide we are giving for 2017 of 2.4% is that the number, Brad? 2.4% of revenue, Steve, that's a good number.

Steve Tusa - *JPMorgan - Analyst*

Okay.

Bob Livingston - *Dover Corporation - President and CEO*

I'd almost say it's a good top end number for the next couple of years. You have to appreciate we still have, even with all the cost takeouts and energy over the last couple of years, Steve, we didn't impair assets.

Steve Tusa - *JPMorgan - Analyst*

Right.

Bob Livingston - *Dover Corporation - President and CEO*

So with respect to production tooling and autoclaves and everything else, we are -- we actually won't see the standard level of CapEx within the energy business that we perhaps saw in 2011, 2012, 2013 and 2014.

Steve Tusa - *JPMorgan - Analyst*

Okay, one last quick one on first-quarter, just kind of clarifying what the range Nigel put out there, you had said up modestly? Up modestly from the 52? I mean, 55 to 60 I'm not a math guy but that's a --

Bob Livingston - *Dover Corporation - President and CEO*

I'm not either.

Steve Tusa - *JPMorgan - Analyst*

That's a 10% growth rate there. So that would even seem to be a little bit more punchy than what you're talking about, just to make sure everybody's level set, did you say up modestly or did you say up double digits?

Bob Livingston - *Dover Corporation - President and CEO*

No actually -- I said to Nigel, I'm not going to argue with you.

Steve Tusa - *JPMorgan - Analyst*

Okay. Okay. I guess that's the answer we'll have to take. Thanks a lot.

Bob Livingston - *Dover Corporation - President and CEO*

Thank you.

Operator

Julian Mitchell, Credit Suisse.

Julian Mitchell - *Credit Suisse - Analyst*

Just on the fluids business --

Bob Livingston - *Dover Corporation - President and CEO*

Good morning.

(Laughter)

Julian Mitchell - *Credit Suisse - Analyst*

Good morning. I know we're short of time so -- pumps had swung to a slight growth rate in Q4. Having been down very significantly in the preceding six months.

How do you see pumps revenues playing out in 2017? Was that some sort of a lumpiness in Q4 that now reverses?

Bob Livingston - *Dover Corporation - President and CEO*

Yes. It is interesting. Good pick up on that and good question. It has been something that we have all been watching pretty closely here in the second half of the year, and I will tell you, we actually started to see a turn, albeit extremely small in the third quarter.

We actually had a -- sequentially a little bit of pick up in revenue third quarter over second quarter; and gosh, Brad, I think fourth quarter versus third quarter it was 3% or 4% improvement in our pumps revenue, so we were very pleased to see that. We're actually forecasting a little bit of growth, and organic growth in our pumps business in 2017. We're not going to see it in the first quarter. We've got some, I would call it, some unfavorable comps just with respect to activity against the first quarter of last year.

There is a little bit of project activity that flows through this part of our portfolio. But we -- for our standard pumps and we're seeing the pick up in general industrial activity, not in oil and gas, but for standard pumps we are continuing to see and expect some substantial improvement in standard pumps. When you put it all together and look at some of the project activity the first quarter is not have as strong of a showing as we saw in the fourth quarter or that we'll see in the remaining part of 2017.

Julian Mitchell - *Credit Suisse - Analyst*

Thank you. And then my follow-up would just be on the extent of your ambitions on sort of further portfolio moves. Obviously 2016 is extremely active, you spent about $1.6 billion on M&A, $200 million coming in from divestments. How are you thinking about 2017 in that context?

Bob Livingston - *Dover Corporation - President and CEO*

A bit more modestly. We've got an active pipeline but I will -- to be quite frank, it's near-term over the next three, five, six months, there's nothing of size in our pipeline. You may see us close on a couple or maybe even three, I would label them as smaller acquisitions, and Brad, it can't even be at $100 million -- all three of them are much less than $100 million, so they are small bolt-ons and add-ons. But I would also tell you, don't be surprised if you see another divestiture announcement here in the next few months.

Julian Mitchell - *Credit Suisse - Analyst*

And buybacks are sort of far down the --

Bob Livingston - *Dover Corporation - President and CEO*

But the activity will be light compared to 2016.

Julian Mitchell - *Credit Suisse - Analyst*

Got it, and buybacks?

Bob Livingston - *Dover Corporation - President and CEO*

I think we will do our best to offset dilution this year but beyond that, I'd like to keep the capital available for growth initiatives and M&A.

Julian Mitchell - *Credit Suisse - Analyst*

Very clear. Thank you.

Operator

Andrew Kaplowitz, Citi.

Andrew Kaplowitz - *Citigroup - Analyst*

Good morning, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning.

Andrew Kaplowitz - *Citigroup - Analyst*

Bob or Brad, can you talk a little more about the increased investment at the Company and specifically within Engineered Systems? You mentioned at the Investor Day that you want to develop your products and your technology faster.

Can you give some color on what specific end markets within Engineered Systems you are targeting? Are you targeting that refuse truck market, and whether the focus of these end markets is going to be market share gain or maybe to offset the more difficult markets you've seen recently?

Bob Livingston - *Dover Corporation - President and CEO*

Sure -- so let's see, I think in our guide, Brad, we have $0.10? As $0.10 impact on EPS guide for 2017 with respect to our growth investments. So let's say rough number, that's about $25 million. I would say half of that is within Engineered Systems.

And when I said -- to be more specific, half of that $25 million is actually within our printing and ID platform and it's pretty evenly split between our marking and coding business and our digital textile business. And marking and coding it's both, I call it some advanced and a little bit faster sort of -- how do I want to describe -- not so much around a product launch, but let's call it some technology development that we'd like to bring on a little bit quicker than we had in our three-year strat plan that we looked at a year ago or six months ago and some channel development.

We've got a little bit more we want to do in our marking and coating business around channel development and so we have greenlighted these investments. They'll be phased-in during the year but we have greenlighted these investments.

Within digital textile, two main areas for the increased incremental investment, number one is around channel mostly related to service capability development, especially in some of the emerging markets that we are now starting to sell equipment into. But the one item that's different that we're going to fund this year is a technology center or even a center, let's call it a center of excellence that -- that's focused on more than just working with our print customers. But it's going to be set up in a way that it actually encourages and helps facilitate the owners of the labels, the fashion houses, to actually allow us to get a little bit more engaged with them at an earlier point of the design cycle to also promote and push the use of our equipment. So it's about half and half, but the bulk of it is in printing and ID.

Andrew Kaplowitz - *Citigroup - Analyst*

Okay, Bob. That's helpful, and then just unrelated, can you give us a little more color on the $20 million in restructuring approximately that you're going to spend here in 2017? What's interesting is if you look at 2016 the $40 million, you really didn't spend much at all on refrigeration. The segment margins as you said, and you'd underperformed your expectations.

We know you've been working hard on sort of changing the manufacturing process as you talked about, but do you not need to spend a little more restructuring on refrigeration? Where does it go in 2017?

Bob Livingston - *Dover Corporation - President and CEO*

Well, what you're asking about restructuring and as part of that within refrigeration; within our retail refrigeration business, the answer is no. We may have a little bit of carryover within the segment but it's actually not related to retail refrigeration. Do you want to provide some color?

Brad Cerepak - *Dover Corporation - SVP and CFO*

Kind of going back to what I said before and the $20 million, the lion's share of the way we think about that right now is for synergy benefits related to Tokheim and Wayne integration. I'd say half of that. I think I used the number before, $9 million or $9 million to $10 million. We'll see how that develops, but that's the current thinking of half of that going into Fluids. Some of the spend is also going to be in DES as we continue to do some restructuring in some of the industrial business that we have there.

Like Bob said, very little in terms of DRFE and then very little in terms DE as well, so that's kind of the way we're thinking about it right now.

Andrew Kaplowitz - *Citigroup - Analyst*

Thanks, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Good. Thank you.

Operator

John Inch, Deutsche Bank.

John Inch - *Deutsche Bank - Analyst*

Thank you. Good morning, everyone.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, John.

John Inch - *Deutsche Bank - Analyst*

Good morning, guys, just want to ask about the tip or tie gains that are $0.03 higher than what you said on January 12. Why would that be the case?

Brad Cerepak - *Dover Corporation - SVP and CFO*

Just the simple true-up to the final accounting, that's the simplest way to say it.

John Inch - *Deutsche Bank - Analyst*

Okay. And then, Brad was there an offset to the $0.05 tax benefit. I know you don't -- these things move around a lot. I just wanted -- it's complicated, there's a lot of moving parts this quarter, I just wanted to make sure if there was an offset to that?

Brad Cerepak - *Dover Corporation - SVP and CFO*

To the $0.05?

John Inch - *Deutsche Bank - Analyst*

Yes.

Brad Cerepak - *Dover Corporation - SVP and CFO*

That's our discrete tax benefit. There is no real offset to that, no, so you can think about within the guide, the previous guide range, of $3.00 to $3.05, the discretes put us, if you include them, are at the upper end of the range, if you exclude them are at the lower end of the range versus where we were previously.

John Inch - *Deutsche Bank - Analyst*

Okay.

Brad Cerepak - *Dover Corporation - SVP and CFO*

We don't -- as you know we don't forecast discrete tax benefits for their very lumpy. They come when they come, so to speak, there was an international piece associated with this $0.05, and some state related reserves, so very much tail-end related. In fact we had to wait to see the year complete itself before we knew for sure whether we met the goal to release them and that's why it was very late in the game.

John Inch - *Deutsche Bank - Analyst*

That's fine. What were the fluid margins ex Wayne and Tokheim. I just was looking at my notes and I think they were 19.3% a year ago if you ex out deal cost and purchase accounting. That may not be wholly accurate. I just I think I remember that; so I'm just curious.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Well, we have the number at -- I'd say excluding restructuring and deal costs and the like, last year I have 18.3%.

John Inch - *Deutsche Bank - Analyst*

Okay. What were they this quarter ex Tokheim and -- I guess Tokheim is not in there. What were the ex Wayne?

Brad Cerepak - *Dover Corporation - SVP and CFO*

Ex Wayne and Tokheim -- Tokheim is still acquisitions, it crests over in 2017. I'm sorry. Let's make sure we've got our years right here. In 2016 it was 18.3%. Are you asking for what 2015 was?

THOMSON REUTERS

John Inch - *Deutsche Bank - Analyst*

Yes. I was trying to compare the apples to apples, Brad, I'm sorry so the fourth quarter of 2015.

Bob Livingston - *Dover Corporation - President and CEO*

That was full year.

Brad Cerepak - *Dover Corporation - SVP and CFO*

19.7%.

John Inch - *Deutsche Bank - Analyst*

That was 19.7%, and then what was it in the fourth quarter of 2016 if you ex out Wayne?

Brad Cerepak - *Dover Corporation - SVP and CFO*

18.3%

John Inch - *Deutsche Bank - Analyst*

18.3. Right. Got it. Okay. That was all I had. Thanks much.

Bob Livingston - *Dover Corporation - President and CEO*

Very good. Thanks.

Operator

We have time for one final question this morning. Our final question will come from the line of Joe Ritchie with Goldman Sachs.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Joe.

Joe Ritchie - *Goldman Sachs - Analyst*

Maybe going back to Steve's question earlier on cash flow, so the quarter was about -- the year was about $50 million lighter than we expected. Is that -- is that predominately because of an inventory build, because orders were better is that -- did I hear that right earlier?

Bob Livingston - *Dover Corporation - President and CEO*

Well, no actually I don't know if I can say predominant. I know it was one of the characteristics that was different in the fourth quarter, especially in December.

I would also tell you that we actually didn't have the rollover in Hillphoenix revenue in December like we normally see. And Hillphoenix is a pretty big generator of cash for us in the fourth quarter historically, so it is a little bit of inventory and a little bit of DSO; but I'm telling you there's nothing unusual in it, Joe.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes, 50/50 maybe on that $50 million split between receivables and inventory.

Bob Livingston - *Dover Corporation - President and CEO*

What is unusual from an operating perspective is to actually see us build inventory through the quarter.

Joe Ritchie - *Goldman Sachs - Analyst*

Well, so that kind of brings me to my follow-up question, right? Because as we are progressing through 2017 it looks like you're basically forecasting high teens cash flow growth year over year at a time when your orders are improving, and I would expect some type of inventory build. And so how are you guys thinking about inventory and just more generally net working capital for 2017?

Bob Livingston - *Dover Corporation - President and CEO*

Okay. I don't have an exact number here, but I know we've got working capital -- our working capital target for 2017. I don't have the absolute number.

I know we are -- our internal targets are to reduce our working capital metric. I think it's 60 or 80 Bps in 2017, with most of the emphasis, most of that improvement coming out of inventory.

Joe Ritchie - *Goldman Sachs - Analyst*

Okay. So all right so the plan is to reduce inventory while orders are going to get better. Okay.

And then maybe the last question, you guys mentioned in the Fluids business that there's improved activity in petrochem in 2017. Is that a function of some of these petrochemical crackers that are getting completed in North America? Or what's really --

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Bob Livingston - *Dover Corporation - President and CEO*

No. I -- I wouldn't label North America as a big driver of that for us this year. We have participated in this. We continue to participate in that, but the upside in 2017 we're actually starting to see some of the emerging economies especially in China. In fact, our -- we've had some pleasantly to note, we've had even here early in January, we've had very strong start on order activity in China with respect to this vertical.

Joe Ritchie - *Goldman Sachs - Analyst*

That's good to hear. Thanks, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Thank you.

Operator

That concludes today's Q&A session. I would now like to turn the call back over to Mr. Goldberg for any closing remarks.

Paul Goldberg - *Dover Corporation - VP of IR*

Thanks, Kristin. Yes. This concludes our conference call. We thank you again for your continued interest in Dover and certainly look forward to speaking with you again next quarter. Have a good afternoon. Goodbye.

Operator

Thank you, ladies and gentlemen, that does conclude the fourth-quarter 2016 Dover earnings conference call. You may now disconnect your lines at this time and have a wonderful day.