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DOV.N - Q4 2022 Dover Corp Earnings Call

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OVERVIEW:

DOV reported 4Q22 YoverY organic revenue growth of 9%. For 2023, expects YoverY organic revenue growth to be 3-5% and adjusted EPS to be $8.85-9.05.

CORPORATE PARTICIPANTS

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

Jack Dickens

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

CONFERENCE CALL PARTICIPANTS

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

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

David Emerson Ridley-Lane *BofA Securities, Research Division - VP*

Guy Drummond Hardwick *Crédit Suisse AG, Research Division - Research Analyst*

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

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 Fourth Quarter and Full Year 2022 Earnings Conference Call. Speaking today are Richard J. Tobin, President and Chief Executive Officer; Brad Cerepak, Senior Vice President and Chief Financial Officer; and Jack Dickens, Sr., Director of 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. Jack Dickens. Please go ahead, sir.

Jack Dickens

Thank you, Gretchen. Good morning, everyone, and thank you for joining our call. An audio version of this call will be available on our website through February 21, and a replay link of the webcast will be archived for 90 days.

Dover provides non-GAAP information and reconciliations between GAAP and adjusted measures are included in our investor supplement and presentation materials, which are available on our website. Our comments today will include forward-looking statements based on current expectations. Actual results and events could differ from those statements due to a number of risks and uncertainties, which are discussed in our SEC filings, we assume no obligation to update our forward-looking statements.

With that, I'll turn the call over to Rich.

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

Thanks, Jack. Let's get started with the performance highlights on Slide 3. Dover delivered strong organic revenue growth of 9% and margin improvement of 150 basis points in the fourth quarter. Volume mix, price/cost and prior period reduction actions all contributed to the positive performance.

As we've been forecasting throughout 2021, the relationship between supply chain constraints of bookings has continued to play out in Q4. The majority of the labor and component availability and logistics constraints have dissipated to resulting in production lead times returning to pre-pandemic levels. Importantly, our 4% annualized through-cycle organic bookings growth rate reflects the continued secular demand strength across our businesses. Our order backlog remains elevated compared to normal levels and provides us with a good top line visibility going into 2023.

Our continuous efforts to improve productivity and efficiency, principally enabled by advances we achieved in e-commerce adoption, back-office consolidation and SKU or SKU complexity reduction resulted in robust margin accretion in the quarter. We expect benefits from our recent efforts to further accrue in 2023. We continue to deploy capital with portfolio improvement, organic growth and production efficiency in 2022.

Our capital expenditures in 2022 were the highest in recent Dover history, and we continue to invest in manufacturing productivity projects and proactive capacity expansions to fuel our top line growth and margin improvement capabilities.

We also completed 5 attractive bolt-on acquisitions in '22 that provide exposure to high-growth technologies and end markets. And finally, we took the opportunity to return capital to our shareholders, including the completion of our $500 million accelerated share repurchase, which was completed in quarter 4. We entered 2023 with a constructive stance. Demand trends remain healthy across our portfolio, and we have a significant volume of business and backlog entering into the new year.

Expected revenue growth, price actions and productivity measures from 2022 lay the foundation for margin accretion in 2023. We have high confidence in Dover's (inaudible) end markets, flexible business model and proven execution playbook continuing to deliver earnings growth. Our strategy for robust through-cycle shareholder value creation remains unchanged to combine solid and consistent growth above GDP, strong operational execution, generating meaningful margin accretion over time and value-added disciplined capital deployment.

As a result of this, we are forecasting full year revenue guidance of 3% to 5% organic revenue growth and adjusted EPS of $8.85 to $9.05.

I'll skip Slide 4, and let's move on to Slide 5. Engineered Products revenue was up 16% [to] quarter continuing the trend of double-digit top line growth through the year. Revenue growth was broad-based across the portfolio, particular strength in North America. Margins continued the sequential build throughout the year, finishing Q4 at 20%, up 620 basis points year-over-year, primarily driven by improving supply chains and price cost dynamics, products mix as well as investments in productivity initiatives.

Clean Energy & Fueling finished the quarter and the year roughly flat. On an organic basis, revenue performance in the quarter was up in clean energy components. Vehicle wash, fuel transport and below-ground retail fuel offsetting the comparable decline in dispenser and EMV card reader demand in the period.

Margins in the quarter were up 170 basis points on positive price/cost and the mix impact from both organic and inorganic investments that we made in clean energy components and vehicle wash. This was augmented by further cost reduction actions initiated in the third quarter and the full year carryover of these actions will continue to accrue in 2023.

In Imaging & Identification volumes for our marking and coding printers, spare parts and consumables were strong in all geographies with the exception of near-term softness in China due to the COVID impact. Our software businesses continue to perform well with penetration of key customer brand accounts with strong growth in SaaS portion of our serialization software.

FX remained negative heading into absolute revenue and profits in the segment given its large base of non-dealer (inaudible). Q4 margins in Imaging & ID were very strong at 25%, improving 250 basis points on stronger volumes, pricing actions and products -- product mix richness. This business has delivered exemplary margin improvement in the last few years as it utilizes our productivity tools for e-commerce, back-office consolidation and offshore engineering.

Pumps & Process Solutions was up 4% organically for the year but posted a 4% decline in the fourth quarter, driven principally by post-COVID transition in biopharma space. The non-COVID biopharma business has continued to grow, and our overall biopharma business is well above its pre-pandemic level.

New orders for biopharma connectors inflected positively in the fourth quarter after several quarters of sequential declines. All other business of this segment posted solid organic growth in the fourth quarter with particular strength in polymer processing equipment and precision components on the back of improved conditions in energy markets.

Operating margin for the quarter was 29% as comparable revenue mix of products delivered. Top line in Climate & Sustainability Technologies continued its double-digit growth in the fourth quarter, posted 27% organic growth across all business geographies. Demand trends remain particularly robust in heat exchangers and CO2 refrigeration systems, driven by the global investments in sustainability.

Our capacity expansion programs in both these businesses remain on schedule and will continue to allow us to continue to meet growing customer demand. Margins were up 450 basis points in the quarter and over 300 basis points for the full year on improved productivity in food retail and strong volume growth and good mix of product delivered.

I'll pass it on to Brad here.

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

Thanks, Rich. Good morning, everyone. I'm on Slide 6. The top bridge shows our quarterly organic revenue growth of 9%, driven by increases in 4 of our 5 segments. As expected, FX was a substantial headwind at 5% or $94 million and impacted both revenue growth and profitability. FX headwinds resulted in Q4 and full year 2022 negative EPS impact of $0.10 and $0.35, respectively. Recent euro gains against dollar have reduced our forecasted FX headwinds in 2023, which we currently estimate at $0.05 to $0.10 for the full year EPS.

M&A contributed $58 million to the top line in the quarter, a product of $80 million from acquisitions, partially offset by $22 million from divestitures late in 2021. We saw strong organic growth across most of our geographies in the quarter. The U.S., our largest market, was up 7% organically. Europe was up 19% organically, driven by particular strength in polymer processing, beverage can making, natural refrigerated systems and heat exchangers. All of Asia was down 1%. China, which represents approximately half of our business in Asia declined by about 10% in Q4, driven by short-term impacts from the COVID resurgence.

On the bottom chart, bookings were down year-over-year due to foreign exchange translation and normalizing lead times across several businesses. Now on our cash flow statement on Page -- Slide 7. Free cash flow for the year came in at $585 million, down year-over-year on increased capital expenditures, onetime tax payments and investments in working capital supporting growth. At our current earnings margin, we would expect to generate free cash flow of approximately 13% of revenue in an average year.

2022 free cash flow lagged behind that level due primarily to elevated working capital investments, driving 2/3 of the gap. As previously discussed, our view -- we view incremental investment in inventory over the past 2 years as productive despite its carrying costs, enabling us to deliver 17% cumulative organic top line growth and over 30% growth in absolute EBITDA between 2019 and 2022.

We are now focused on extracting back cash invested in inventory. As supply chains improved in the fourth quarter, we began reducing inventory, particularly finished goods. The majority of excess we carry into 2023 is in raw materials, and we expect to consume a significant portion of that excess in the first half of the year.

In addition to inventory reductions, we expect to collect elevated receivables from the fourth quarter and normalize our payable balances, driving significant improvement in working capital in 2023. We also forecast lower CapEx following a stepped-up CapEx year in 2022. As a result, our forecast for 2023 free cash flow is between 15% and 17% of revenue.

I'll turn it back to Rich.

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

Okay. I'm on Slide 8. I'll be brief on this slide since we've been discussing the linkages between bookings, backlog and revenue and expected trajectory of these metrics for nearly 2 years. First, I'll remind everyone that in 2021, bookings of $9.4 billion, driven by post-COVID demand surge as well as constrained supply chains that required customers to order in advance were roughly 20% higher than our revenue that year resulting in an unprecedented backlog that requires time to ship and unwind while bookings normalize.

Importantly, concerns about double ordering and cancellations did not materialize and we have been depleting the backlog in an orderly fashion as product lead times improved. If we smooth out the post-pandemic surge in bookings, our bookings CAGR has been 4% from 2019 to 2022.

Let's go to Slide 9. Here, we show the growth in margin outlook by segment for 2023 that underpin our guidance. We expect Engineered Products to remain solid. Pent-up demand and automation initiatives and waste hauling support a robust outlook. Despite high demand, our refuse collection vehicles shipments in 2022 is still has not recovered to pre-pandemic levels due to chassis availability.

After an excellent (inaudible) performance in Vehicles Services group in Q4, we expect a slower start in 2023. And Engineered Products is forecast to improve margins in 2023 on solid volumes, benefits from our recent productivity capital investments taking hold and positive price cost tailwinds. Clean Energy & Fueling is expected to grow single digits organically, which we expect to be second half weighted due to uptime demand for dispensers entering the year.

Dispenser bookings beginning to normalize, we expect Q1 to be the trough for the business with gradual recovery through the remainder of the year. All other businesses in the segment are positioned well for growth in 2023 with particular strength in our clean energy components. For the year, we expect margin improvement for energy and fueling and volume recovery, improved mix and recently enacted restructuring actions in above ground fueling.

Imaging & ID is expected to continue its trajectory steady GDP growing at an attractive margin. We see robust demand for new printers and components and consumables and professional services, the outlook for the both serialization and brand potential software is also strong. Margins in this business are robust, and we expect them to remain as such in 2023.

We project flat organic growth in Pumps & Process Solutions, our industrial pumps and plastics and polymers precision components and thermal connector businesses and are all positioned for solid growth. The biopharma components business is expected to hit its bottom in volume and margin in the first quarter as customers work through and repurpose excess inventory.

We are beginning to see encouraging signs of bookings for our biopharma connectors and our full year forecast may prove to be conservative. The long-term tailwinds of single-use components or biological drug manufacturing remain compelling. And importantly, our products are specified for regulated manufacturing of therapies with attractive growth outlook, and we continue to win new specifications in an active pipeline of new biologics and cell and gene therapies.

Margin performance is expected to be roughly flat in the year with a sequentially lower level in the first and second quarters unfavorable product mix from slower biopharma and geographic mix from higher sales in China for plastics and polymers. Growth outlook for climate and sustainability technologies remain solid as our businesses continue to ship against strong backlog levels. We are forecasting continued double-digit growth in both natural refrigerant systems and heat changes for heat pumps.

Our beverage can making business is booked well into 2023. We expect continued margin improvement in 2023 on volume conversion, productivity gains and mix. Move on to Slide 10. Here, we show our recent performance against our capital allocation priorities.

Our priority is to reinvest in our business, which represents the highest return on investment. 2022 represented a recent record for CapEx with numerous capacity expansions and productivity investments completed. We will continue our efforts to add attractive bolt-on acquisitions to improve our portfolio by entering new markets with secular growth. We invested $325 million into 5 highly attractive acquisitions in 2022. We're carrying significant firepower in a compelling M&A pipeline into 2023. Finally, as we did in 2022, we will return excess liquidity to our shareholders through increased dividends and opportunistic share repurchases.

Let's move on to Slide 11 for the wrap up. Before we get into our full year guidance, I'll make a few comments on our view of the macro environment and how we believe the year may develop. First and foremost, we hope that the Fed is cautious going forward from here. We support the efforts to tackle inflation, which had a large hand in causing, but we are in the camp that believes that the Fed has gone far enough and the lagged effect of further actions can be problematic to economic growth.

Market participants are likely to be cautious with the timing of the demand-generating decisions as there is a recognition that manufacturing lead times and logistics constraints had been largely repaired. And as such, we expect first quarter demand to reflect this cautious stance. We expect seasonality to the year to be weighted towards quarter 2 and 3 in revenue and earnings and weighted to H1 for cash flow as our balance sheet reflects liquidation of inventory and receivables from 2022.

Despite the uncertain macro, our goals remain ambitious. We will push hard to win our share of demand. We have done a lot of work to improve the performance of our products, and we believe we will have the right to win. We have proactively expanded capacity to meet projected demand in areas of the portfolio with significant secular growth opportunities.

So now let me put our guide in EPS performance for the longer-term perspective. Our objective is to deliver double-digit through cycle EPS growth for our investors through a balanced mix of healthy revenue growth, margin accretion and value-creating capital deployment. We have been delivering on that equipment, not that commitment, and we drive -- we'll continue to drive to continue to do so.

I want to thank our customers for trusting Dover businesses to deliver on their important needs, and I'm grateful that Dover teams across the world for continuing to serve our customers and execute well despite various challenges along the road. That completes the comments.

So Jack, let's go to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We'll take our first question from Andrew Obin from Bank of America.

David Emerson Ridley-Lane - *BofA Securities, Research Division - VP*

This is David Ridley-Lane on for Andrew Obin. So there are different reasons for each segment, but the guidance assumes better second half growth than 3 of the 5 segments. What's kind of the underlying demand assumption? Are you assuming things are fairly stable? Or do you embed kind of a deterioration in underlying demand given you're seeing better second half growth in several segments?

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

I think that the feedback that we're getting from our customers is to start off the year cautiously. I think that there's in a lot of portions of the marketplace, there's inventory that needs to be depleted. And I think that there's a concern about the macro. There also is this view that inflation is coming down and that being prudent about when to start projects is probably going to put them into money.

Furthermore, I think they have a difficult comp in Q1 just because of FX alone. So I don't think there's anything other than, as we mentioned, biopharma -- me getting to the bottom where we expect orders to inflect positively from there. I think it's just an overly cautious stance going into the new year.

Everybody knows that lead times have been prepared -- have been recurred well, not as if they have to put the orders in and take the deliveries in Q1. So it will actually go back to what had been historically the seasonality of the Dover portfolio, where a little bit of a slow start second quarter and third quarter quite high and then rerun for cash in Q4.

David Emerson Ridley-Lane - *BofA Securities, Research Division - VP*

Got it. And then a quick one on China. I heard you that you've seen some demand disruptions given the COVID resurgence. Any concern about labor-related disruptions at your operations or suppliers showing up later this year?

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

No. I mean, our -- from a supply standpoint, we are not overly levered towards China with the exception of electronic components, which don't make a disproportionate high amount of our purchases. So no, I don't -- I think that China, we -- the stance is it's going to get better from here, not worse.

Operator

Our next question comes from Jeff Sprague from Vertical Research.

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

Rich, just on the order normalization agreement or talking about this for a long time. Do you kind of expect things to revert back to that kind of historical balance for your backlog is, call it, 20% or so of forward sales by the end of the year? Or do you think this takes a bit longer to normalize?

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

Well, a lot of that depends on the macro, Jeff, at the end of the day. But yes, I mean, yes, we would expect to go back there. I would call your attention to the slide that we had at the end of Q3 that showed normal backlogs by segment, we would expect to go back there. If '19 is normal, let's say. I think that's what the comparative number there is, we would expect it to go back there. And -- but it may flex over time, well, again, I'll leave it at that. I will go back to -- I would call your attention to that slide, and that's where we're going to end up.

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

Okay. Great. And then your -- the comments to the prior question kind of touched on this a little bit. But the nature of my follow-up here is, what is the price discussion like on orders now. Now that, as you say, kind of supply chains are normalizing and there's the expectation that inflation does begin to fade. Do you see downward pressure on price and maybe put that in the context of what your own cost equation looks like in 2023?

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

Yes. We've been pretty disciplined in terms of not repricing our backlog, for sure. So I don't expect any issues there that are not manageable. I think that what we can expect at the beginning of this year is everybody having a view, and this includes us when we deal with our own suppliers that inflation is coming down, if I spend some time in Q1 renegotiating, maybe I can force the issue to a certain extent.

So in our estimates, we don't have any unannounced pricing that's not out in the marketplace, meaning there's not baked into our numbers and the other price increase in the June time period. But it's going to be -- it's going to be interesting to see how it develops over time. I think it's going to be reflected more in a delay in terms of the order rates until we get into a position of back and forth of when do you need the product and when do you have to stop negotiating the price.

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

And that algorithm leaves you price cost positive for the year as it stands now?

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

Yes. Yes. Our estimates are price cost positive for the year based on roll forward, basically, what you see in Q4.

Operator

Our next question comes from Steve Tusa from JPMorgan.

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

So it just -- you have these backlogs, right, and you expect them to -- you expect to work them down over the course of the year. Why wouldn't that mean that assuming that those lead times, I mean they are extended, but I wouldn't think too extended given the nature of your business. Why wouldn't that liquidation of backlog help kind of the normal seasonality, assuming that you -- the trend line is what it is, but you're delivering out of backlog, which should help sales in the near term. Why are customers not taking this stuff earlier?

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

Well, a lot of them are based on their own CapEx plan. So as we talked about at the end of Q4 about decline in dispensers, it was kind of interesting to us because we were shipping heavily in the belowground and hardly shipping anything in above ground, and that was a reflection of the delay in getting these projects done because of supply chain constraints and labor and everything else, I think that we're going to see a little -- that's an example.

We're going to see a little bit of that more in Q1, right? So despite having the backlog, the customers are not saying you know what? Deliver it on January 1, and I'll go put it in the warehouse and I'll pull it out what I want. They just don't feel the need -- that's what was kind of going on in the marketplace to a certain for a period of time.

As that accordion effect is beginning to unwind, yes, the backlog is there, but they're saying, "You know what, here's the timing of my project and I may want it in March, I may want it in April, so the depletion will be orderly over the balance of the year.

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

Got it. And then how much price are you assuming this year in the organic?

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

I don't think that we disclose that, but it's a good portion of the organic growth is price.

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

Okay. And then 1 last 1 for you, just on orders. I think to get to that level of backlog at the end of the year, looks like it's roughly, I don't know, like a $2 billion backlog, assuming a mid-single-digit growth rate, which should imply roughly $6 billion of orders. Is that -- does that feel about right?

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

Let me do it in my head, yes, that's close, yes. It's going to be very much contingent of what happens in the long-cycle portion of the business, right? The Maags and the Belvac and to a certain extent, SWEP, which is becoming a long-cycle business because we're beginning to rather than sell the profit to selling capacity. So if those 3 hang in there, then yes, that's where we'll be.

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

Yes. Okay. That -- and those would be the toughest comps in the first half.

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

Correct.

Operator

Our next question comes from Joe Ritchie from Goldman Sachs.

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

So Rich, I just want to make sure I understand your seasonality comments as it relates to the first quarter, if I go back to like prior seasonality, you could see the first quarter being kind of like a high teens percentage of the full year to kind of mid-20s. I mean if I use the midpoint, it kind of puts me around the $2 range if I'm doing that right, for the first quarter. I just want to make sure that I'm level-setting correctly.

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

Joe, I don't have Excel open here in front of me. I'd like to come back on it. Just look, at the end of the day, this is just a general statement about the feedback that we're getting from the marketplace, right? Everybody is concerned about recession. And so there's a bias towards being very careful with inventory, us included.

So we just think that the take-off is back to the question that Steve asked before is that the backlog is there, but the take rate on that backlog should start out slowly, right? Until everybody gets in place, where we can -- a lot of what we deliver goes right to the project site in a lot of cases, at least the businesses that aren't tethered to distribution. So I'm not calling for a collapse in Q1 by any stretch of the margin. But we don't want to -- the only reason that we're calling it out is we're coming out of periods where we had very strong Q1 and the seasonality versus the past got a little bit out of whack.

So we're just telling you to just be careful with Q1. The full year is the full year, and we're confident in that. But I think just we have to be -- we have to recognize that there's an amount of caution in the marketplace and everybody is going to be very careful about how much inventory they lay in until they can see what's going on with kind of the macro, per se.

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

Got it. No, no, that makes sense. I guess maybe my quick follow-up. I think last quarter, you guys had called out, I think, like a roughly $0.23 benefit in DCF from the cost actions and you're continuing to highlight kind of margin improvement this year. Can you maybe -- so firstly, are you still on track for that $0.23? And then secondly, across the rest of the portfolio, where are you seeing opportunities for margin expansion in 2023?

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

I think all of the $0.23 was not in clean energy. I think $0.19 of the $0.23 if I remember correctly, more or less, is in there, yes.

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

And some of that was in the fourth quarter too.

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

Yes. And some of that was a fourth quarter also because we actually took the cost actions in Q3. But everything is on track. What you do is you get -- you get a bad comp in that business because it was still delivering pretty heavily in Q1, but we expect that to be offset by clean energy components and below ground and car wash, which are margin accretive. So you get basically over the year, a positive inflection of mix on the portfolio, but I think you just have to be a little bit careful in Q1 just because the above ground is a bad comp.

Operator

Our next question comes from Andy Kaplowitz from Citigroup.

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

Rich, could you give us a little more color regarding your expectations for DPPS ['23]. What's your conviction level in terms of biopharma connectors destock ending in Q1? I know you mentioned book is inflected sequentially. And then you're -- just in terms of margin, I know you're forecasting flattish for the year in this segment. Given where Q4 '22 left off, it's not that easy to get there. So maybe you could elaborate on your cost controls and productivity actions in that segment that gets you back to those '22 levels?

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

Yes. Well, we did take cost out as volume came out of the sector for sure, and we did that progressively through the year. And I think we took a further action in the end of Q3, Q4, more or less. Look, orders are beginning to inflect.

We are paying a lot of attention to the commentary of our customers out there who are basically saying it's an H1 event and then expect to have all the inventory cleared. I will tell you that we have not been overly ambitious in our estimates for the full year. So I think if we're going to -- I think that we may have a little bit more difficult H1, but I think that we've got a better and even chance to have a better-than-expected performance in the second half of the year.

But what we'd like to see is the order rates come up and us start expanding capacity to deal with it, which I think we can turn around to do it. So yes, the flat margins year-over-year. We're going to have to be really careful with our cost controls, and we're going to have to deliver polymers and plastics and precision components are going to have to deliver on the volume that we expect to get out of those businesses. But it's not like we're being overly ambitious in volume in biopharma for the year.

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

Great. And then, Rich, I know you don't want to tell us all about your Investor Day in March. But maybe in terms of -- you've talked about portfolio management a little more frequently lately, maybe update us on that. And then, obviously, you talked at the beginning of your prepared comments around SKU management. We know you've been really focused on costs. So in terms of longer-term margin targets, anything to sort of talk about their preview there? I assume margins can rise pretty significantly from where they ended in '22?

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

Well, I mean that's going to be part of it, Andy, at the end of the day. So let's not the cart before the horse, but we're going to basically do what we did back in '19 and try to give you a 3-year forward role of segment and what we think the contributing factors to it. I mean a lot of it is going to be ongoing productivity, but I think what's underestimated is that the organic revenue potential is underestimated. And I think we've done a lot of work in terms of mix here. So the mix of the products that we have today versus what we started with in '20 is, I think, a lot different than that was back then.

So it's not some ambitious we're going to grow completely out of the order. I think we'll grow higher than basically the market expects us because we generally get bottom quartile expected growth rates and revenue, but I think mix is going to be the most important aspect of it.

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

Do you expect to give a specific target around organic growth? Or is it like GDP plus?

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

I don't know yet.

Operator

Our next question comes from Scott Davis from Melius Research.

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

The -- I probably asked this a couple of quarters ago, but the M&A markets, Richard, they come down to kind of more holistic levels for you guys and expect to be a little bit more active in '23?

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

Well, I guess taking on any leverage to do a deal has not been well received by anybody. So I guess we'd have to be careful with a larger deal presently for whatever reason, the capital markets are not looking kindly on leverage for, I guess, the reasons we can understand about unsurety of the macro going forward. But yes, I think that what we've seen so far is that a realistic multiples are now becoming -- are reflective of what's going on in the capital markets. So you always have -- most of our deals are private, as you know, private companies. There's always a lag between the public capital markets at a private valuation. I think that, that has narrowed towards to the public capital markets.

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

Okay. And I don't like the traffic of minutia, but is there such a thing as a can-making cycle? I mean what -- it seems like we've had pretty high demand year for several years in a row. What -- what's in the other side of it? Is there a big investment cycle now and that it's just kind of air pockets after that? Or is there some new dynamic involved in that world?

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

Yes, I'm not allowed to say that the AP, right? Because the CTAs love on that step. But yes, look, I mean, it is a cyclical business and there are investment cycles and part and parcel is to not overcapacitize yourself as the cycle goes up and the recapture on the spare parts, which are margin accretive on the way down. So that's the way that we look at the business.

Now having said that, it will be interesting to see what happens with PET in drinks going forward. I know that there's been a little bit of a pushback on ESG lately. But the fact of the matter is that PET from an environmental point of view is not a preferred option.

So to the extent that the cost plus ESG aspect of PET over time, make aluminum more attractive, then we could -- that is by far the largest portion of the market. So even if a recapture rate of 15% of PET market would drive another cycle. So that's kind of where we are right now.

Operator

Our next question comes from Josh Pokrzywinski from Morgan Stanley.

Joshua Charles Pokrzywinski - *Morgan Stanley, Research Division - Equity Analyst*

Rich, so you've been sort of holographing what's happened with orders and backlog and kind of watching the Fed movements for a while now and been more concerned about them we're doing it. Does your view of kind of downturn management look different because of some of the scarcity that we've had the last 2 years in terms of hiring folks, looking for new suppliers, maybe honoring existing agreements. Does any of that look different with the recovery on the other side, we kind of have more of the same scarcity that we've had in the past.

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

Yes. I wouldn't expect to run into the logistics constraints that we've seen. I think that was a one-off. I mean, you had just such a collapse of the macro and then a restart and then you had a lot of -- the energy markets went haywire which drove the logistics market say, well, I don't expect that to happen. I mean I think that capacity was brought on. And if you look at logistics costs and the forward curves there, I don't expect that to repeat under any reasonable macro scenario from here.

I think there is a lot of liquidity that's being taken from the general market. I think that lending is very low right now. It's very difficult to get loans and secure loans -- secure liquidity to run businesses out there. I'm not making it a Dover comment. I'm talking in total. So I'm concerned about that. And if that's the case, and there's the only way that if you're a private company, the only way you can generate liquidity in order to continue to fund yourself is to draw down inventory balances to extremely low levels, and that's negative to orders and revenue going forward.

So that's our overall concern of -- I don't see the point of bringing out another 50 basis points only to turn around and give the 50 basis points back into Q4. Why bother? Why can't we just sit where we're standing right here because liquidity in the market is incredibly tight right now. So that's the fear. At the end of the day is that you have a delayed CapEx cycle, which we ascribe to the fact that there is a CapEx need out there because of productivity to offset higher labor costs, and then you've got all the stimulus money out there. But fact of the matter is there's no liquidity to accompany that I think that you have a delay effect that could be problematic.

Joshua Charles Pokrzywinski - *Morgan Stanley, Research Division - Equity Analyst*

Got it. That's helpful. And then just thinking about the 4Q orders, any sense from you guys as lead times have improved that this is sort of the quarter where customers kind of squeeze the accordion on, hey, we don't need things 16 weeks earlier than normal anymore. So let's get back to maybe more normal ordering pace. Like -- is there an artificial low that you go through on orders as lead times normalize? Or is that something that's kind of barely perceptible over the medium term?

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

No, that's exactly what we think, and we think it's going to continue through Q1. And then from there, we expect based on our view of the demand cycle that it will inflect positively from there. But I think you're going to get another quarter of exactly how you described it, right? I know I can get the product. I have enough inventory to carry me through the quarter. I'm going to take the chance of depleting it because I know you can deliver into Q2.

Operator

Our next question comes from Guy Hardwick from Credit Suisse.

Guy Drummond Hardwick - *Crédit Suisse AG, Research Division - Research Analyst*

Rich, I think on the last call, you talked about a fundamental change in the business model in DCEF. Are you ready to talk a bit more about that today?

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

Well, I would leave that to the Investor Day, right? I mean, I think that my comment was is that -- we went through this period of EMV and then we went through this period of the overhype EV taking over the world, and we were basically saying that we believe that we can position this business to harvest profits for 20 years. And I think that we're -- we've made the moves in Q3 of this year to begin to position ourselves appropriately there, right?

So there was no sense of doing it in advance of a rising revenue curve. But now that it flattens out, we've got to run that business differently on one hand. And on the other hand, we've been a pretty active acquirer in that particular segment as we transition to clean energy exposure, particularly in the hydrogen space. So we're doing it -- but I would -- if you're looking for, what does that mean going forward from here in a holistic way, why don't we wait until March and we'll surely talk about it.

Guy Drummond Hardwick - *Crédit Suisse AG, Research Division - Research Analyst*

And just a follow-up. Could you clarify that backlog math? Where do you think you could be at the end of the year?

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

Why don't we take this off-line because everybody's got a different calculation of if it's -- I think that there was 20% of the annual revenue should be in backlog in a normal time. So we got what our forecast is for revenue for this year. So it's a relatively easy calculation.

Operator

Our next question comes from Nigel Coe from Wolfe Research.

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

So Rich, a couple of ground here. But just going back to the caution. You seem to talk about inventory and your inventory management more so than projects. I'm just wondering if you have to generalize, would you say the cautions more on CapEx? Or is it more the channel partners managing inventory levels very tightly. And would you say it's U.S. versus Europe? Would you say both are in the same camp? Or would you say the U.S. is right now where you've seen the more caution?

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

I think it's a U.S.-centric comment. I mean if you look at our growth rate in Europe, I don't think anybody would have modeled that considering kind of the overall caution about Europe in total, but frankly, a lot of what we do out of our production base in Europe gets -- we recognize the revenue in Europe, but it may end up around the world at the end of the day. But I think -- it's more -- we don't -- our exposure in terms of -- our exposure is larger in North America, so it's largely a North American comment. I don't -- I think that Europe, any kind of let's call it, destocking would have happened during this past year because they were on the front end of the curve.

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

Right. Okay. That's helpful. And then just you mentioned free cash flow more loaded to the first half of the year, which is obviously very unusual. You mentioned that the bulk of your excess inventories were material. So that doesn't seem to have an impact on your fixed cost absorption. But I'm wondering as you go through the inventory management, are you expecting there to be some margin penalty as you build inventories?

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

No. Actually, I think that in our models, it's a margin credit as we liquidate it because if you look at forwards based on when we bought that inventory sequentially grew 2022. It's actually -- and you can see it in our margins in some of the sectors, that's parcel to this price cost. Look, at the end of the day, yes. If I go back and look over the last couple of years, we made a significant investment in inventory and that allowed us to deliver revenue growth that was above expectation.

So now lead times and availability and capacity is repaired itself. So we get almost a triple effect of -- we liquidate kind of the excess raw materials that we've been carrying to meet demand because we slowed down production, in Q4, our payables balance dropped significantly.

So from a net working capital point of view, we got the negative of shipping heavily in Q4. So there's a big receivable balance that gets liquidated build probably in the latter half of Q1, but more in Q2, our payables expand and then we collect on that receivables balance. So all 3 come in, in the first half.

Operator

And our last question comes from Julian Mitchell from Barclays.

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

Thanks for squeezing me in. Maybe, Rich, you'd mentioned mix once or twice as a factor, and we can obviously see that impact in DPPS as well documented. I just wanted to circle back to the DII segment. There was a mixed tailwind, I think, in fourth quarter possible headwind in the year ahead guided and that's weighing on the margins there. Maybe expand a little bit on that.

And DEP had an exceptional margin expansion, albeit off an easy base. Is there anything much moving around on mix in DEP?

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

In DEP, no, I think rightly, I would look at DEP sequentially as opposed to comp, right? We all know what happened in Q4 of 2022. So that's why we had been saying all year that not to worry because as price cost rolls forward, you're going to get what you get. But I would look at DEP on a sequential basis as a precursor of what you can expect into '23. And the other question you had was on marking and coding, right?

That is just a function of the amount of consumables we shipped in any given period, meaning the more that you ship in printers, that is negative to margins. The more that you ship in consumables, it's positive. It's going to bounce around. I think that our comment that we made on that particular business is that the margins are quite robust, and it's all about what kind of revenue growth we can get from here. We're not calling it down for '23.

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

That's helpful. And then just a follow-up on kind of firm-wide Dover operating margin. So I think the operating margin overall was flattish in 2022. It's guided maybe to grow a little bit in 2023. I just wondered with that backdrop, is there the appetite maybe to accelerate restructuring spend. I saw in your guide, you've got kind of $0.10, I think, for 2023 after $0.20 last year.

But I wondered just sort of thinking ahead, is there maybe the appetite to drive -- make sure that '24, let's say, has stronger margin expansion and that might require more restructuring this year.

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

Well, Julian, I mean, I think to the extent that we have flat margins despite the fact that our biopharma business, which is clearly our most profitable portion of the portfolio being down, one could argue that once we get to the strong -- we get through this destocking period, which we expect to be an H1 '23 event is that inflect back to the positive that the incremental margins that we're going to see there.

And all things being equal, we hold and continuing to improve the balance of the portfolio that, that by itself is margin accretion. But I think I would call your attention to what we've done in Climate & Sustainability. We think that that's got room to run. We think that we've gotten DPPS we've just talked about. I think we've got some growth there. and we've got the return of biopharma in the second half of the year, which by I'll repeat myself, I don't think we've been overly ambitious with that.

We think we're going to keep that in our back pocket and see how the market develops. And the roll forward on the Engineered Products, if we look at what our exit rate is and we roll that forward, I think that's quite healthy from a margin point of view. So back to the restructuring. Look, we're always scouring our fixed costs around here.

Our management is incentivized to deliver fixed cost reduction and incremental margins. So I would expect we'll continue to do so, but I don't see any need to accelerate it to protect our performance going forward.

Operator

That concludes our question-and-answer period and Dover's Fourth Quarter and Full Year 2022 Earnings Conference Call. You may now disconnect your line at this time, and have a wonderful day.
