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DOV - Q2 2018 Dover Corp Earnings Call

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OVERVIEW:

Co. reported 2Q18 revenue of $1.8b and adjusted EPS of $1.30. Expects 2018 adjusted EPS to be $4.75-4.85.

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PRESENTATION

Operator

Good morning, and welcome to Dover's Second Quarter 2018 Earnings Conference Call. Speaking today are Richard J. Tobin, 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 and your participation implies consent to our recording of this call. If you do not agree with these terms, please disconnect at this time.

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

Paul E. Goldberg - *Dover Corporation - VP of IR*

Thank you, Crystal. Good morning, and welcome to Dover's second quarter earnings call. With me today are Rich Tobin and Brad Cerepak. Today's call will begin with comments from Rich and Brad on Dover's second quarter operating and financial performance and some comments on our 2018 outlook. We will then open the call up for questions. (Operator Instructions)

Dover is providing non-GAAP measures, including EPS results and EPS guidance that exclude after-tax related amortization. Reconciliations between GAAP and adjusted measures reflecting adjustments for aforementioned acquisition-related amortization, rightsizing costs and other costs are included in our investor supplement and presentation materials. 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 August 2 and the audio portion of this call will be archived on our website for 3 months. The replay telephone number is (800) 585-8367. When accessing the playback, you'll need to supply the following access code: 3666317.

And before we get started today, 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 Rich.

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

Thanks, Paul. Good morning, everybody, and thanks for joining us for this morning's conference call.

Let's get started. In Q2, Dover posted consolidated revenue up 3% with adjusted earnings of $200 million and adjusted diluted EPS of $1.30 a share, up 19% and 21%, respectively. Bookings remained solid at $1.9 billion at the end of the quarter and are broad-based across the portfolio, excluding retail refrigeration. The Apergy spin-off was completed at the beginning of the quarter and as a result, we have executed a good portion of the announced share repurchase program, which Brad will take you through the impact on the share count later in the deck. We are tightening the full year EPS guidance range to $4.75 to $4.85 a share despite the full year demand environment in retail refrigeration being below our original forecast and largely as a result of improved margin conversion in the Fluids segment expected in Q4, tight corporate cost controls and share count reduction.

As we have noted in the press release this morning, we will be implementing a cost reduction program beginning in Q3, which is not reflected in our current full year EPS guidance and will be subject to a separate announcement. And I will deal with that, I think, in the Q&A.

So let's go onto the presentation. Let me pass it off to Brad.

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

Thanks, Rich. Good morning, everyone. Let's start on Page 4 of the presentation deck. As mentioned, our results were largely driven by solid demand in Engineered Systems and Fluids. Overall, revenue grew 3% to $1.8 billion. Adjusted segment EBIT improved to $276 million and adjusted margin was essentially flat at 15.3%. This performance reflected solid conversion in Engineered Systems, which was offset by continued footprint consolidation, supply chain issues in Fluids and lower volume in Refrigeration & Food Equipment. Adjusted segment EBITDA was $343 million. Adjusted earnings increased 19% to $200 million and adjusted EPS was $1.30. The EPS benefited from a slightly lower tax rate on discrete tax benefits, whereas the full year effective tax rate is expected to be between 21% and 22%.

On Slide 5, let's get into a little bit more detail on our revenue and bookings results in the quarter. Second quarter revenue growth of 3% was comprised of 3% organic growth and 2% from FX. Partially offsetting these results was a 2% impact from net dispositions. Importantly, on a sequential basis, organic growth accelerated from 1.7% in Q1 to 3.5% in Q2. FX, which was a tailwind of about 4% in Q1, decelerated into Q2 to about 2% as a result of the U.S. dollar appreciating against our other trading currencies. We are using a U.S. dollar-euro assumption of $1.17 in our current full year forecast.

From a segment perspective, Engineered Systems grew $39 million organically and Fluids grew $44 million. Weak retail refrigeration markets drove a $24 million decline in Refrigeration & Food Equipment's revenue. Bookings increased 6% overall. Organic growth was 6%. Of note, Engineered Systems and Fluids organic bookings grew $62 million and $80 million, respectively, reflecting broad-based market demand. From a geographics perspective, the U.S., our largest market, grew 2% organically, while Europe was up 1%. Asia grew 19%, largely driven by strong activity in our Fluids segment. Finally, book-to-bill finished at 1.05.

Let's go to the earnings bridge now on Slide 6. Starting on the top. Engineered Systems adjusted segment [EBITA] improved $15 million, largely driven by solid conversion and broad-based revenue growth (corrected by company after the call). Fluids [EBITA] growth of $7 million reflects weak conversion due to footprint consolidation and supply chain issues (corrected by company after the call). The $15 million decline at Refrigeration & Food Equipment reflected lower volume. Going to the bottom of the chart. Adjusted earnings improved $32 million or 19%. Higher segment earnings, lower interest in corporate costs and a lower tax rate drove the improvement.

Let's look at Slide 7. Our first half free cash flow was $79 million or 28% of earnings from continuing ops. Second quarter free cash flow was largely in line with last year. Our CapEx spending was focused on multiple projects which will help drive growth and productivity. Working capital increased $59 million on volume growth, although working capital as a percent of revenue came down 130 basis points to 16% of revenue.

Now on Slide 8. As previously mentioned, during the second quarter, we initiated an accelerated repurchase program funded by the $700 million Apergy dividend. Beyond the completion of the ASR, we expect to repurchase $150 million more in shares in the second half on the open market. By year-end, we will substantially complete the $1 billion repurchase we committed to last year. And as you know, the ending full year 2018 weighted average drops further into '19 on these 2018 repurchases.

With that, let me turn it back over to Rich.

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

Thanks, Brad. Let's move on to the segment slides. Engineered Systems delivered a solid broad-based quarter. Margin conversion organic revenue was very good at 46% in the period, a result of the following. In Printing & Identification, the positive comparable performance was driven by volume growth in Markem-Imaje and improved product mix in Digital Print as a result of the timing of LaRio printer deliveries, which had been expected in Q3 but delivered in Q2.

In the Industrial platform, performance was more mixed as they are more subjected to material costs and tariff issues. ESG and TWG both delivered very strong performances as a result of the continued demand strength in fleet renewal in ESG and recovery vehicle accessories demand in TWG, with volume leverage and mix more than offsetting input cost headwinds in both businesses. DESTACO and MPG delivered good results on volume and improved mix on the back of automation demand and an uptick in military spending. While VSG reported absolute profits up for the quarter, incremental margins were lower than expected as volume leverage and pricing are unable to cover input cost increases as a result of the delays in pricing implementation, which is being enacted going into H2. The full year outlook for Engineered Systems is expected to remain strong with earnings levered towards Q4 as a result of industrial facility maintenance shutdowns primarily in Europe in Q3 and the timing of Digital Print large printer shipments pulled into Q2.

Okay. Let's go forward to Fluids. The Fluids segment posted organic revenue growth of 7% during the quarter with all operating companies growing revenue from comparable period, with especially improved performances in our pumps, process solutions and transport businesses. Consolidated margin performance for the segment was underwhelming as a result of the execution issues in fueling and transport, specifically in DFS, partially offsetting strong performances in the balance of the segment.

Let me comment on some of the strong results in the segment because it's a little bit of a tale of 2 worlds here. In pumps and process solutions, PSG, Colder, Hydro and, to a lesser extent, Maag, all delivered top line and bottom line conversion in the quarter. PSG's June shipment rate was the highest in 3 years, which is a positive sign that our CapEx-levered businesses continue to gain strength. The Colder business has a strong -- has had a strong start to the year, which continued through Q2. This is becoming a business of significant attraction in the segment's portfolio and one that is earmarked for capacity expansion.

Results in fueling and transport were mixed. OPW is the fastest-growing business at 23%, largely driven by regulatory-related spending in China and U.S. below-ground products. Margin conversion could have been better as a result of facility consolidation costs which we consider transitory and beneficial to margins going forward and the geographic mix of revenue, with APAC revenue being dilutive to consolidated margins. The expectation is that OPW will have a solid second half as end market demand remains firm.

DFS, while posting top line growth of 3%, posted negative earnings conversion as a result of the continued operational costs associated with the European footprint consolidation, significant supply chain costs and expediting fees and discrete items in the quarter. Our expectation is that a significant portion of these issues will be behind us by the end of Q3 and that the second half performance will be materially improved going into Q4.

What I can tell you is that during the quarter, the operational issues and discrete items have cost us approximately $7 million of earnings and, if I add that back to our margins, there still remains much to do to get margins on track in this business. The encouraging news is that we are confident it's not a product issue. From a performance perspective, as product benchmarking and customer feedback is positive. It is clear that our operational execution has to improve and we have to establish and execute clear paths for profit improvement plans in Europe and APAC, which are underway.

Let's move on to Refrigeration & Food Equipment. Refrigeration & Food Equipment had another tough quarter in Q2 as revenue was down 6%, primarily driven by reduced demand trends, especially in Dover Food Retail; and calendarization of shipments out of food equipment, particularly at Belvac, which are back end-loaded in 2018 to Q4. We have updated our full year forecast for this segment and aligned it with the current backlogs and demand trends. EBITDA margin in the quarter declined over 200 basis points or $15 million on reduced earnings in Dover Food Retail of $14 million and Belvac on $4 million on a comparable basis.

Our expectation is that the full year demand will remain weak in Dover Food Retail for the balance of the year, but for comparable segment margin declines to narrow in Q3 and refuse -- and reverse in Q4 as a result of improving shipment mix in united brands through H2, Belvac and Belvac shipments in Q4 and the flow-through of cost actions in Dover Food Retail, which has reduced its year-over-year headcount by 18% through June.

Moving on to Slide 14. As I mentioned earlier in the presentation, we have updated our full year revenue outlook to reflect softer-than-forecasted demand conditions in retail refrigeration and tightened our range on the EPS to the higher end of the range, with a bias towards the top end. Our revenue trends and backlogs indicate we have strong businesses that are largely participating in markets with increased demand profiles. It is clear that we need to execute on better margin conversion in some areas of our portfolio and to aggressively implement actions to offset raw material and input inflation. During the last 90 days, I have visited approximately 70% of our total company revenue and their management teams in the quarter. The commitment to deliver improved performance is there and we are committed to implementing the necessary actions to achieve it.

That's the last slide. So we will move on to Q&A.

Paul E. Goldberg - *Dover Corporation - VP of IR*

Thanks. Crystal, if we can have the first question?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Julian Mitchell with Barclays.

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

Welcome to Richard, and thank you for the candid tone. In terms of -- I guess, any extra color you could provide on the cost reduction measures that you've talked about in terms of magnitude and perhaps also speed of execution and how quickly investors should expect to see a meaningful payback on those cost reduction efforts?

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

We're well through our plans. I expect that our plans will be complete by mid-August. From there, we'll work on the accounting treatment, quite frankly, because there's some issues we have to deal with, warrant notices and a variety of other things. Before the end of Q3, we will be announcing the timing of those measures, the cost of those measures and the flow-through on our cost going into '19 as a separate announcement. But I guess in a nutshell, we're well underway at this point. I'm confident in our ability to execute. I think as a clarifying point, what I'd written in the press release said overhead, and I don't want to confuse that with what has gone on here before about rightsiFzing, if you will, nor do I want you to think of that as that -- as corporate costs. This is SG&A across the group, including the SG&A in the segment. So the scale of this rightsizing initiative will be materially larger than some of our rightsizing initiatives that we have seen as a result of the Apergy spin-off.

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

Understood. And then my second and last question would just be around the Refrigeration & Food business. And I guess, you've obviously done a lot of cost measures already at food retail. It seems like you've obviously decided to keep the business in light of the reviews you have done in recent months. Maybe talk a little bit about your impressions on the longer-term sales growth outlook in Refrigeration & Food overall and how that informs the scale of necessary cost reduction.

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

The cost reduction initiatives are solely in retail refrigeration because that really is the part of the portfolio that's suffering the revenue decline. I think from an earnings point of view, both UB -- UB is on track for the full year. I think that we've got some calendarization differences running through the P&L right now in Belvac. So if you look at the segment performance, it's negative to a certain extent because of Belvac. Our backlog in Belvac is impressive right now. It's purely a question of the timing of the deliveries. Right now, they're loaded into Q4 and that's why, in my commentary, I'd said that the comparable performance for this segment actually rolls over in Q4 where we expect it to be positive, which is largely as a result of the cost takeout in retail refrigeration and the shipments in Belvac. So in terms of the portfolio review and the decision about keeping anything, I mean, we've gone through the portfolio review in terms of what we can expect about medium-term performance, but there's been no real decisions about a greater portfolio decision at this point. I think that -- I understand that there's this issue of, well, why don't we spin out Refrigeration or monetize Refrigeration? Monetizing the business at its current demand levels, I'm not so sure about that from a decision point of view. So I think what we're doing right now is rightsizing that business in terms of what we believe the demand is going to be for the balance of the year. We'll have a better idea as we go through Q3 of what we expect to happen in 2019 and we're committed to making sure that we maximize the segment profitability through that period. In terms of what we're going to do from a portfolio point of view, I think that's a future consideration.

Operator

Our next question comes from the line of Andrew Obin with Bank of America Merrill Lynch.

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

So the question is, I guess, a question for Rich. As you moved from the board to the CEO position, and I know you sort of highlighted SG&A moves, are there any obvious things other than SG&A in terms of how the company run that you have seen as a target for improvement? And the second part of my question, how long would it take for you, you think, to sort of steady the operations at Dover, move them in the direction where you want where you can sort of restart thinking about using the balance sheet strategically, i.e. M&A?

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

Okay. I think there's 2 primary issues. One is clearly that the expectation of demand in retail refrigeration of what we thought it was going to be at the beginning of the year and what it's likely to -- turning out to be for 2018 is significantly different. And that goes through to 2019. So I don't -- I believe that we're reaching the bottom from what I can ascertain so far, but right now, we're moving as quickly as we can to intervene on the cost base to protect margins as they are. We will make further decisions based, as I mentioned in the previous question, about where we stack up on -- we're taking a lot of costs out right now and we're incurring those costs through the P&L with what kind of on-the-run margin profile is for retail refrigeration on a variety of demand scenarios into 2019. But clearly, that's a significant difference between what we had thought at the beginning of the year and what it's turned out to be, so it's up to us to action that. And quite frankly, segment management has been doing a lot of heavy lifting so I can't criticize the execution of the cost takeout year-to-date. The other issue is the execution on the facility consolidation in DFS and the margin profile of that portion of the Fluids segment has been disappointing. This has been ongoing for some period of time. I think it has demonstrated that there are some gaps in the organization about handling facility consolidation and complex industrial moves and we're paying the price for that. So right now, in terms of margin dilution accretion, we've got a significant portion of the Fluids segment that is very dilutive to the balance of the portfolio and that's a problem. We're getting our hands around about on-the-run profitability for that segment if I can strip out some of the noise, but we are not moving fast enough, in my mind, in terms of the execution. I think that we'll make some progress in Q3. So comparable earnings trajectory versus the first half, will move up in H2, but we're still far away from expectation in terms of the margin of that business. And it's significant to our revenue stream so it's something that we need to fix. And I think that, that is going to undertake us, bringing in a mix of some other kind of talents into the group to ensure that -- because there was other footprint initiatives that I think that will be coming through 2019 and we just got to do a better job of executing there. In terms of inorganic investment, this is not a scenario of, well, we're going to go through a cleanup period here and then we're going to come out on the other side. We're still looking at inorganic opportunity and the balance of the portfolio. We've got certain portions of our business that are executing very well. I mean, I highlighted some of them in the opening commentary. We are looking at a few right now and the scale, in terms of purchase price, is somewhere -- it's less than $0.5 billion, but more in the $250 million range.

Operator

Our next question comes from the line of Jeffrey Sprague with Vertical Research Partners.

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

Just on the maybe some of the more kind of practical near-term operational things, can you just give us a little color on really what the supply chain disruptions are? How do you tackle those? And also just a little bit of an update on what is happening on price/cost, in particular your efforts to get price in the business?

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

Sure. For the most part, the supply chain issues that we've had that have been negative to earnings have been mostly isolated in Fluids and almost exclusively in DFS. And that is part and parcel to this facility consolidation to a certain extent and trying to manage our S&OP systems in terms of getting the right product out. So we've had a bunch of frictional costs associated with that, whether that's freight expediting. On the balance of the group, it's being reflected in working capital performance where I think that the supply chains in certain parts of the business have been somewhat strained. I think in certain areas we've tried to buy forward a little bit on the industrial businesses with steel to kind of mask price increases to a certain extent, and that really needs to be normalized going into the second half because we're not entirely pleased with the cash flow performance year-to-date. So those are really 2 of the areas where it's manifesting itself.

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

And how about on price attempts? Specifically, Rich, how's the market accepting that? Is there kind of negative demand response in attempting to get price or any blowback anywhere on that?

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

Yes. Well, we've got a pretty mixed portfolio, so an answer I'd give you is going to be kind of mixed. I mean, I think that we've estimated that our commodity headwind is approximately $55 million or so that needs to be offset in price. Clearly, in the business, I called out VSG, where we've been negative so far and that's a little bit because of that's a distribution business and there's a tail on kind of rolling that into distribution, which we're committed to fixing in the second half of the year. The other businesses like TWG and ESG, which are heavily levered towards commodity prices because of the demand profile has been there, they're doing reasonably well on price and they're offsetting the balance because of the volume leverage on the industrial side.

Operator

Our next question comes from the line of Steve Tusa with JP Morgan.

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

On the free cash flow, you mentioned -- you just mentioned some working capital. I know the prior guidance was 10% of revenue. I know you have a big second half usually. Can you maybe just update us on that metric for the year and then maybe a little color on how it may improve in the next couple years? And then just a quick follow-up on that.

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

I'll take the time to avoid the next couple of years, Steve, for the time being. I can deal with that in Q3, but let's deal with between now and the end of the year. I'm not aware of anything that's changed in the dynamic -- or the cash flow dynamic of the business right now. So I'm not taking 10% of revenue off the table by any means. Clearly, as I'm sure you heard during the Q3 commentary, we did -- we are back end-loaded in certain of our businesses and that would imply that receivable balances in the Q -- in Q4 may be going up. But that -- so we're going to have to work pretty hard in terms of the industrial inventory and payables to offset that, but I don't see any fundamental change that we've moved to a heavier profile in terms of inventory or cash conversion. But getting into kind of doing the timing quarter-by-quarter, it's hard for me to say right now. I've gone through it at the opco level. I think any kind of fluctuation in that is going to be based on timing of receivable balances. And if at the end of the year, we're shipping out a bunch of LaRio machines and shipping out a lot of Belvac, I mean, that's going to be negative unless we can carry some payables to offset into it. But right now, I don't see any reason to come off 10% of revenue in terms of a target.

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

Okay. And then just a quick one on RF&E. You talked about taking rightsizing actions. I don't see really any of the restructuring in the quarter at Refrigeration. Is that because a lot of the plan that you're going to kind of come up with and announce is -- it's more kind of let's stop things, let's evaluate and this -- that will be a big part of kind of what we'll hear about in Q3, like kind of a calm before the storm, if you will?

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

A little bit less so than you think. I think that the rightsizing that's been going on in Refrigeration has been flowing through the P&L on the variable labor side more than anything else. I think that what we're going to do in this segment is take a look at the footprint because the footprint is probably -- well, it is, right now, at current demand levels, a lot larger than we would need, so there's going to be a part of that in it. But to be clear, the restructuring that we're going to announce in Q3 is not -- is more of a group-wide SG&A reduction. There'll be some amount of footprint in it, but quite frankly, I think that the footprint decisions are going to take a little longer. And that will be done, I don't want to say separately, but I mean, as you can imagine, you need to prepare supply chains and do a variety of other things to deal with the footprint, so a lot of that will probably go into 2019. What we're going to do in this coming quarter is take a look at across all of the segments, so group-wide SG&A, because clearly, as we've taken a look at the benchmarking versus our peer set, we're a bit heavy. I think we've done a lot of work in the past to put in systems to allow us to take out some non-customer-facing kind of costs and that's what we're going to do.

Operator

Our next question comes from the line of Steve Winoker with UBS.

Steven Eric Winoker - *UBS Investment Bank, Research Division - MD & Industrials Analyst*

I just wanted to start with a little bit more of that operational review that you've had across the whole business. You've talked about hitting 70% of the revenue base. You've talked about SG&A and some of the supply chain issues. But to what extent is there a sort of a broader operational and lean opportunity when you see how the businesses are working? Do you think these are really just isolated incidents or is this more of an opportunity, kind of rethinking the operations of the business forward on a portfolio basis?

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

Yes. I think that, right now, we are concentrating on the actionable items. So SG&A, clearly, is an actionable addressable item. And as we mentioned, we've got some pretty big execution issues that we need to deal with in DFS and DFS is a material portion of our total group revenues. And clearly, we're kind of swimming upstream a little bit on retail refrigeration until that business stabilizes itself. So there is a lot we can do in terms of operational performance that it's going to require that, but that is more of a sustained, kind of grind-it-out effort. So I mean, it's not something that we can turn the dial between now and the end of the year other than to begin to turn it philosophically. But in my going around, I think that we do need to bring into some of our businesses some expertise in terms of operational efficiency. I think we do a fantastic job of keeping close to the customer. I think we do a really good job in terms of new product development. So the kind of close to the customer and developing the products, which is reflected in our top line, which has been very competitive against our peer set, I think that part of it we do quite well. I think that we just need to take that kind of effort and turn some of it back in terms of operational execution. But that is something that is -- we can put it in it as an ethos between now and the end of the year, but we're going to have to grind that out and that's more of a 18 months before we really get on a cadence that I'd like to see it on.

Steven Eric Winoker - *UBS Investment Bank, Research Division - MD & Industrials Analyst*

Okay. And just to clarify on the comments this morning, when you talked about asset intensity, you mean driving higher asset utilization across the business?

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

Yes, absolutely. Absolutely. I won't use intensity again. We're not going to become more asset-heavy. We are going to sweat the assets that we have more intensely.

Steven Eric Winoker - *UBS Investment Bank, Research Division - MD & Industrials Analyst*

Perfect. And then -- I had to get that in. But on the EMV side, can you just talk to us a little bit about EMV growth?

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

Somewhere in this pile here is the chart. Where do we say we were on EMV penetration, 40%?

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

Yes, roughly 40%. That's hard to know because we're seeing more and more -- we're seeing more and more new dispensers. A lot of customers are looking at the age of the dispenser in the field in making decisions about earlier upgrade than maybe they normally would do and we're seeing that manifest itself in order rates on dispensers. The first half, as you know, was a challenging first half because EMV last year was pretty solid in terms of kits and the conversions. The back half, we'll see that more to dispensers. So -- but roughly speaking, the number Rich gave is about where we think we are with a lot of room to continue to run here in the back half into '19.

Operator

Our next question comes from the line of Deane Dray with RBC Capital.

Deane Michael Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

Maybe we can start with what you're thinking, and I know it's a moving target, regarding potential tariff exposures. And you mentioned the $55 million in commodity headwinds you need to offset, but any color there for starters would be helpful.

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

Yes. The $55 million is a mixed number, which is -- it's got tariff in there and it's got price escalation, right. And parsing that out...

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

It's small.

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

Yes, parsing that out is relatively difficult. We are keeping a close look at our exposure to China in terms of our revenue base, clearly. And not only our exposure from a revenue point of view, but also the mismatch between what we make in China and sell into China versus what we import/export. So we're running the traps on all of that. It looks manageable at this point, so I don't see any significant issue. I'd like to see our Asia Pac margins move up group-wide a little bit, but -- and I mentioned that in the color around OPW, but at the end of the day, from a growth point of view, it's -- from an absolute profit point of view, we'll take it. So we're running the traps on both kind of tariff scenarios, but for us right now, it's less tariff and more commodity cost headwinds and then it's just a challenge for us to offset it between price and productivity.

Deane Michael Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

Got it. And then, Rich, I appreciate that we're still early in your tenure and you're laying out some broad strokes on the operating side and what needs fixing, but can you address capital allocation broadly? You mentioned that you're not going to stop on acquisitions. You're looking at $250 million to $500 million-sized deals. But broadly, how are you thinking about return requirements? Are there any changes that we should be sensitive to in terms of how you're looking at capital allocation broadly?

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

We're looking closely at it. We -- I'm very cognizant that everyone is looking for a structured answer from me on that. Our intent is, hopefully, before the end of Q3 or around the close of Q3 that we're going to come out and I'll give you a whole presentation in terms of my thoughts on capital allocation. In the short term, Brad alluded to what we're doing in terms of the share repurchase as a, a, it was a commitment in the past, but it's a relative valuation play at the same time. So I think we've given you a lot of color in terms of our intent there. But I understand that everybody is waiting to hear from me about capital allocation and I'm working on the presentation as we speak.

Operator

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

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

So when you look at Refrigeration, I know there's been a few questions there, but it's been a couple of years where it's been a little tough for Dover. So when you look this quarter, I know Bob had talked last quarter about a couple new customers coming in and booking more. What's happening in the business? What is worse? The CapEx environment, we all know, looks weak. But Bob had talked about specialty store growth. So what -- it seems like it's a moving target and what should it look like from here? Do you think that where we are in terms of guidance is pretty conservative now, Rich?

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

I hope it's conservative, I guess, is -- I mean, when we're talking about retail refrigeration. I think when we look at the segment, it's going to have enough -- it's going to have a tough Q3 and then -- these are comparable numbers now. It's going to have a tough Q3 and then it's going to roll over in Q4 because, quite frankly, the comps get better and, as I mentioned, the non-retail refrigeration portion of the portfolio is back end-loaded right now based on our forecast, so you're going to get that kind of uptick. But the fact of the matter is we're -- nothing's really changed. We're in a bit of a CapEx strike by food retail as everybody struggles with the digitization and what they're going to do to react to that. It is clearly below replacement demand now, so I wouldn't say -- does it get worse from here? I don't think that it gets worse from here, but we don't see a runway for it to get demonstrably better other than to run the trap lines to say, at some point, maintenance capital, replacement capital has got to come back. So but clearly, the proportion of newbuild to replacement build has changed forever to a certain extent and we're going to have to size ourselves based on that. In terms of other revenue streams there, as you can imagine, we are working strenuously to diversify the business from case and door to other products within food retail. I think that we've got some interesting irons in the fire in that regard, but they are not going to impact earnings in 2018. And as soon as we can put some color around it, I'm sure you'll hear from us about it. But for the medium-term, this is all hands on deck of rightsizing, ensuring that our quality remains best-in-class, setting ourselves up for -- even at flat revenue, we actually make comparable profits go up because of cost takeout and then working strenuously and kind of diversifying the revenue stream from a product point of view.

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

That's helpful. Then if you can back up last year at this time or maybe early in the last summer, there was an Analyst Day, Bob had talked about some of these long-term growth guidance for the different segments. Obviously, Refrigeration has changed, but when you look at ES and Fluids, you've laid out 3% to 5% growth and it looks like ES has been pretty strong. So as you looked at the overall segments, Rich, in terms of growth, is that the way you've looked at it is that ES and Fluids look solid versus that 3% to 5% growth, Refrigeration looks a little worse? Is there any comments on how -- those targets that were set last year?

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

Yes. I know that there's a need -- or everybody wants me to reconcile the 2019 targets. I can just -- I asked and I've looked at them closely. Clearly, as you've articulated, both Fluids -- all right. Let's go back. Engineering Systems, from a top line growth and a margin accretion point of view, is largely on track. Fluids, because of the negative conversion in DFS, is problematic and we -- I think we've beaten this issue of food retail. I'm more of a consolidated margin person. This is a portfolio. There's going to be ups and downs in terms of the demand cycle in the portfolio. But if I look at it from a consolidated point of view, part of the reason that we're taking this action in terms of overhead cost is to close that gap, which is a portion of it is our execution issues that we have in DFS that need to be reconciled and, more importantly, the headwinds that we have on Refrigeration.

Operator

Our next question comes from the line of Charlie Brady with SunTrust Robinson Humphrey.

Charles Damien Brady - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Just more of on a bigger picture. You've talked about, particularly in Refrigeration and, I guess, in both Fluids, bringing some more talent in on the operational execution issue. Do you think as you -- and I know it's a little far to 2019, but these types of things generally take a bit more time. You've got to bring people in, you've got to get the plan in place and you've got to execute. I mean, as we look from a margin perspective, particularly on that DFS business and more on Refrigeration, do you see -- kind of going through 2019 before you -- and exiting 2019 before you see any real meaningful margin improvement there or should we expect it sooner than that time frame? I'm trying to get a framework of how long do we see sort of some of these subpar margins in parts of the business before they start getting really better on the plan you're going to put in place.

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

Right. As I mentioned earlier, I'm -- from an execution point of view on Refrigeration and the actions that have been taken on the cost bases, I'm confident that the plans are in place for the comparable margin to rise. It's purely a question of demand. So it's a top line issue, right. So I think that segment management is on it from a cost point of view. It's not -- there's not an execution issue going on in retail refrigeration. It's more of it's got a significant top line headwind and, because of that, your fixed cost absorption becomes problematic. So it's easy. What they've done up into this point is deal with the variable cost which they take through the P&L, so on a comparable basis, even at flat revenues, it actually moves up going into '19. And then it's clear that we're probably going to have to take some action in terms of the fixed cost in that business to rightsize it based on future demand. We're not there yet because I'm not -- I think we need to see some stabilization in terms of the demand profile on that portion of the business. On DFS, I can tell you that if I clear out the noise of the facility consolidation and everything else, it's a material amount of earnings increase at flat revenue, but I'll also tell you that the profit margin, even if I clear out the noise, is unacceptable from a comp basis. And that is likely to take -- I think we'll make improvement. I think you're going to see some improvement in the second half of this year, largely in Q4. I think that you'll see improvement, assuming we clear out the noise, which we're committed to doing in 2019, but it's going to likely take throughout 2019 to materially get this closer to benchmark profitability, which is our target.

Charles Damien Brady - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Understood. And just one more quick one. You talked about one of the things you think you guys are pretty good at are new product development, that doesn't seem to be an issue. But I'm wondering, as you look across the portfolio, are there areas where things may have been under-invested in terms of new product development and that's an area that needs a little more focus or is it kind of squared up across the board?

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

It's such a mixed bag. I think it's very difficult to answer. I think by and large, as I mentioned before, the customer-facing portion of the business is executing, so and that includes new product development, right. A lot of what we do is I would almost classify as co-engineered in a lot of cases. I think from an investment point of view, if there's been any opportunity in terms of investment, it would be at the industrial level and that's a productivity issue, right. So there may be some amount flex of investing in the industrial footprint to derive future productivity out of it and be less labor-intensive in some of our more industrial businesses.

Operator

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

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

If I may, I'd like to maybe ask you kind of a longer-term question. If you're looking out 3 to 4 years, I mean, I certainly understand what you're trying to do from a cost reduction and restructuring standpoint in the near term, but what is your sense for where the biggest opportunity for value creation would be in the company? Is it on self-help driving margins or is it more along the capital deployment portfolio management side?

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

In the near-term, it's driven by self-help. And in the longer term, it moves more into investing where we're advantaged from a market structure point of view and we believe that we've got advantage. So over the next 18 months, I think it's more of operational execution and self-help. I think that I've basically pointed my finger off where we believe that the biggest material changes can take place, but over the -- but at a certain point, if we execute on that, then it becomes more of an issue of capital allocation and allocating our capital where we believe that we are structurally advantaged in terms of whether it's market structure or product or a variety of other considerations. So but it's not to say, I think I should repeat myself, that we're going into some kind of black period where we're going to almost exclusively concentrate on execution issues. I think that we're able to do a little bit of both. So we are going to be considering inorganic investment over that period of time. So it's not a black white. So you're asking a longer-term question. I think that once we get beyond kind of some of the operational challenges that we have in front of us, then I think it becomes more of a, are we going to be a disciplined allocator of capital? And I think that we're committed to doing so.

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

I see. And then, maybe a clarification on guidance, if you're willing to provide it. Can you comment at all on how you're thinking about segment margin for the full year by each segment?

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

No. I won't give you segment margin for the full year. I think that if you go back and you look of what my comments were, I think that I've given a good amount of color in terms of what our expectations are by segment in terms of calendarization between Q3 and Q4.

Operator

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

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

Rich, it sounds -- just maybe just asking the margin -- longer-term margin guidance question directly. It sounds like -- we talked a little bit about bridging the gap to what the old targets were for 2019. When do you think you're going to be in a position to either affirm or provide new margin guidance on a longer-term basis?

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

Yes. I think that the -- what I alluded to before about coming out and doing, let's call it a Capital Markets Day for lack of a better word, about presenting something about capital allocation. Clearly, as part of that, it's going to be something about what we think about future margin performance is going to be. I just need some time to get it all sorted. And I think it's important that we have a definitive answer in terms of the cost and the roll-forward about the actions that we're going to be taking in the next 90 days as part of that presentation.

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

Got it. That makes sense. And following up maybe on that question earlier on asset intensity and running your assets harder, I'd be curious, just based on your first few months on the job, like how do you evaluate the level of investment that's been made across the businesses and whether you have to make incremental investment in your assets to drive better productivity?

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

I think that the -- as you're aware, I think that the asset base of Dover is diverse, I think, to be kind. So there is ample slack capacity throughout the group and even if you drill down and did that by operating company and segment and everything else. So I think that there is an amount of opportunity, if we're talking about driving longer-term productivity, of changing the profile of some of our industrial assets to make them less labor-intensive over time, but I think that the payback in those investments will be solid. But it is very much a mixed bag between how old the assets are and whether they're industrial assets or nonindustrial in terms of their profile. So it's -- I'll just give you anecdotal comments. But there are opportunities, if we're confident about the revenue streams going forward and the volume, for some amount of automation that may require some amount of CapEx, but quite frankly, I don't think it's going to flex CapEx and the revenue -- as a percentage of revenue demonstratively and I think that the payback will be satisfactory.

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

Got it. Helpful. If I could sneak one more in, just on price/cost. Just on price/cost, it looks like you got in roughly $25 million or so of price in the first half of the year. You're talking about $55 million or so of commodity inflation for the year. I'm just curious, is the expectation in the back half of the year that price/cost is going to be positive based on what you know today, just completely offsetting? Or how are you guys thinking about it within the guide?

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

I think neutral is the best answer I can give you. I mean, you've got so much flex in mix going into the second half and a lot of comparable performance changes. Clearly, we did a -- I think that DES, in most of their industrial businesses, did a great job in Q2, where some high-value shipments where we got out the door quickly. So from a comparative basis, we're going to be really leaning on DFS in Q3 and really leaning on DFS and retail refrigeration from a comp basis in Q4 and because of retail -- not retail refrigeration -- because of DFR being reliant upon Belvac in Q4, which are low shipments in number but very lucrative in terms of its margin profile.

Operator

Our next question comes from the line of Scott Graham with BMO Capital Markets.

Robert Scott Graham - *BMO Capital Markets Equity Research - Analyst*

So we've seen, in the past, facility consolidation issues. We've seen supply chain issues. These are, unfortunately, not new things. So what I'm wondering here is, as we look to slim down improved processes, what is the risk that 2019 becomes one of those infamous transition years for you guys?

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

Well, I don't want it to be my transition. So I think the commitment -- look, clearly, from an execution point of view in DFS, I can't speak to the past. I can just speak to what we're dealing with right now. I think that we could have handled this better, right. I think that I'll put it in my lap. I know how to do that stuff. So I think that it's just a question of doing the preparation beforehand and executing on the plan. And just so -- I think also, as I mentioned, that we are going to be taking it in the industrial footprint, but over the course of the next 18 months. And we may have targeted actions there, but what I can assure you is, is that when we take those actions, that we'll tell you upfront what the cost is going to be and what the time line of the execution is and it's not going to be muddled in kind of on-the-run results.

Robert Scott Graham - *BMO Capital Markets Equity Research - Analyst*

So it's entirely possible that, let's say, for example, the first half of next year could be a little, for lack of a better term, squishy off of what you're trying to do over the next 18?

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

Look, is it possible? I don't think so, I guess, is my answer, right. I mean, I think if it's squishy -- let's take an example. If we want to intervene in '19 on the industrial footprint of retail refrigeration, for example, it would be squishy to the extent of there are some amount of redundant costs, both in preparation for and working capital to prepare to make that transition, right. But those are relatively known and easily measured, right. As opposed to having difficulty with the transition and not starting up appropriately where you're basically having difficulty executing on your backlog and then you get all of the frictional costs associated with that, whether that is redundant labor, significant overtime, freight expediting, paying supplier premiums. That part of it is execution and that's the part that while we may intervene on the industrial footprint, I think that the planning of that and our ability to demonstrate this is what it's going to cost and this is what the time line, that part we'll fix.

Robert Scott Graham - *BMO Capital Markets Equity Research - Analyst*

That's very helpful. And let me just be sort of, maybe a little bit more near-term-oriented here with my sort of second question. You laid it out very clearly that you're leaning fairly heavily on DFS for Q3 and retail refrigeration for Q4. And, I guess, I would say -- and I know that you don't want to go back to the past, but we've kind of done this. We're relying on this thing in the past. And I'm just wondering, do you have sort of plan Bs in those areas or in other areas to make sure that you stay within the guidance range?

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

Well, I mean, we put the guidance out there and I can see that there's some pushback on the $4.85. So I think -- and I told -- what I said was the bias was to the upper end, right. So I think that we're trying to take into account all forecast errors associated with executing the business. Clearly, I think that the comp-to-comp in Q3 is going to be unexciting and it's going to be back end-loaded. I don't see anything in Q4 that could swing the number significantly that wouldn't allow us to make it up, right. As I said, it may -- from a segmental point of view, it may be puts and takes. I mentioned before, we're heavily reliant on Belvac shipments in Q4. If those get deferred into Q1, that's something that we're going to have to make up in DES or somewhere else. So we're -- I'm taking that into account in terms of the movement of the total portfolio.

Operator

That concludes our Q&A session for the day. I would now like to turn the call back over to Mr. Goldberg for closing remarks.

Paul E. Goldberg - *Dover Corporation - VP of IR*

Thank you. This concludes our conference call. With that, we want to thank you for your continued interest in Dover and look forward to speaking to you again next quarter. Have a good day. Thanks.

Operator

That concludes today's Second Quarter 2018 Dover Earnings Conference Call. You may now disconnect your lines at this time and have a wonderful day.