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DOV - Q3 2018 Dover Corp Earnings Call

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OVERVIEW:

Co. reported 3Q18 revenue of $1.7b, adjusted earnings of $203m and adjusted EPS of $1.36. Expects 2018 adjusted EPS to be $4.80-4.85.

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PRESENTATION

Operator

Good morning, and welcome to Dover's Third 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. Thank you.

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, Laurie. Good morning, and welcome to Dover's third quarter earnings call. Today's call will begin with comments from Rich and Brad on Dover's third 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 adjusted EPS results and EPS guidance that exclude after-tax acquisition-related amortization. We believe reporting adjusted EPS on this basis better reflects our core operating results, offers more transparency and facilitates easier comparability with peer companies.

Reconciliations between GAAP and adjusted measures reflecting adjustments for aforementioned acquisition-related amortization, rightsizing 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 November 8 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 159-8024.

And before we get started, I'd like to remind everyone that our comments today, which are intended to supplement your understanding of Dover, may contain certain forward-looking statements that are inherently subject to uncertainties. We caution everyone to be guided in their analysis of Dover by referring to our Form 10-K for a list of factors that could cause our results to differ from those anticipated in any such forward-looking statement. We also undertake no obligation to publicly update or revise any forward-looking statement 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*

Thank you, Paul. Good morning, everyone. Thanks for joining us on this morning's conference call. Let's get started on Slide 3. Organic revenue was up 3% for the quarter. The solid demand trends in Engineered Systems and Fluids more than offset the continued weak demand environment in Refrigeration & Food Equipment. Adjusted Q3 earnings were $203 million and adjusted earnings per share were up 9% and 14%, respectively. Bookings remained solid at $1.7 billion at the end of the quarter and are broad based across the portfolio, excluding refrigeration.

Overall, the quarter was largely in line with our internal forecast and our earnings comments at the end of Q2. We expected a slower Q3 relative to the previous quarter in Engineered Systems as a result of demand calendarization and scheduled production shutdowns at our European operations. Despite this, Engineered Systems margin conversion on volume remained strong at 47%. Fluids performed as expected with solid results in pumps and process solutions, buffering the residual footprint cost in fueling and transport. Refrigeration & Food Equipment proved to be tougher than expected in the quarter and we have incorporated current conditions into our full year guidance.

Our fourth quarter is stacking up to be driven by improved margin conversion in our Fluids segment as we get our operational issues behind us, coupled with the flow-through of our cost initiatives more than offsetting the negative impact of Refrigeration & Food Equipment business and the higher tax rate projected for the quarter.

We have significantly completed our SG&A rightsizing plans during the quarter, which we'll address in the presentation, and then we're moving forward with our footprint rationalization activities, which we expect to begin executing in Q4. As a result of the above, we are further tightening the top end of the range of our EPS guidance to $4.80 to $4.85 per share.

I'll pass it to Brad here and come back during the segment slides. Brad?

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

Thanks, Rich. Good morning, everyone. Let's turn to Slide 4. As mentioned, our results were largely driven by solid demand in Engineered Systems and Fluids. Adjusted segment EBIT was essentially unchanged to $274 million and adjusted margin was 15.7%. This performance reflected strong conversion in Engineered Systems and improved performance in fluids, largely offset by lower volume in Refrigeration & Food Equipment. Adjusted segment EBITDA was $341 million, adjusted earnings was $203 million and adjusted EPS was $1.36. EPS benefited in the quarter from the lower tax rate on discrete tax benefits. The full year effective rate is now expected to be between 20% and 21%.

Moving on to Slide 5. Let's get into a little bit more detail on our revenue and bookings results in the quarter. Third quarter revenue of $1.7 billion was comprised of 3% organic growth, offset by 3% impact from dispositions net of acquisitions. FX was minimal in the quarter. Organic growth remained above 3% in Q3 despite headwinds in Refrigeration & Food Equipment. FX, which was a tailwind of 2.2% in Q2, decelerated into Q3 resulting in a small headwind of 0.5%. We are using a U.S. dollar-euro assumption of $1.17 in our current forecast.

From a segment perspective, Engineered Systems grew $35 million organically and Fluids grew $58 million on broad-based activity. Weak retail refrigeration markets and delayed shipments in can-shaping equipment drove a $39 million decline in Refrigeration & Food Equipment's revenue. Bookings increased 3% overall. Organic growth was 6%. Of note, Engineered Systems and Fluids' organic bookings grew $38 million and $77 million, respectively, reflecting broad-based market demand.

From a geographic perspective, the U.S., our largest market, was flat organically where broad-based growth in Engineered Systems and Fluids was offset by retail refrigeration. Europe was up 2% organically and Asia grew 23%, largely driven by strong activity in our Fluids segment. Finally, book-to-bill finished at 0.98.

Let's take a look at the earnings bridges on Slide 6. Starting on the top. Engineered Systems adjusted segment EBITDA improved $8 million, largely driven by solid conversion on broad-based revenue growth. Fluids EBITDA growth of $9 million reflects better execution in retail fueling and conversion on volume in our other businesses. The $23 million decline at Refrigeration & Food Equipment reflects lower volume and negative business mix. Going to the bottom of the chart. Adjusted earnings improved $16 million or 9%, primarily driven by lower interest in corporate costs and a lower tax rate.

Now on Slide 7. Our 9-month free cash flow was $284 million or 66% of earnings from continuing operations. Third quarter free cash flow was $206 million, was on track with our expectations and largely in line with last year. We expect the fourth quarter to be our highest free cash flow quarter of the year, which is our normal pattern. Of note, the free cash flow impact of our restructuring initiatives on a year-to-date basis was $39 million, of which $11 million was paid in Q3. In all, we expect to deliver full year cash flow within the range that we provided at our Investor Day in September.

Moving to Slide 8. Finally, we completed the open market portion of our $1 billion share repurchase program in the first week of October after repurchasing $148 million in Q3. The $700 million ASR will be finalized by year-end, thus completing the full program.

With that, let me turn it back to Rich.

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

Okay. Thanks, Brad. Let's try to put some color around some of the segment performance for the quarter, starting on Slide 10 with Engineered Systems. Engineered Systems had a solid broad-based quarter with 7 out of 8 operating companies posting improved revenue, driving a top line organic growth of 5%. Margin conversion in the quarter was excellent at 47%, with all operating companies improving profitability quarter-over-quarter.

Our Printing & Identification platform had solid performance in Markem-Imaje and digital printing, both of which posted top line growth greater than the average of the portfolio and accretive margins to the segment. Markem-Imaje's growth is broad-based geographically with particular strength in consumables, which is positive to margins. Dover digital and printing was driven by large equipment shipments and cost control initiatives, offsetting a competitive price environment in inks.

The industrial platform business has all increased comparative profits as our CapEx-levered businesses continue to operate in a constructive demand environment. Our ESG business continued to deliver strong absolute profit results despite having a less rich product mix during the quarter and the continued pressure from higher raw material cost pass-through. Our vehicle service group delivered its strongest margin performance of the year despite its European facilities being down for scheduled maintenance in the quarter.

OKI, DESTACO and TWG continued to benefit from end-market CapEx-driven demand and dealer stocking, and Microwave Products continued to perform in what we believed to be a multiyear constructive environment for military spending.

Going into Q4, bookings for Engineered Systems remained solid. We expect the quarter to be a good one despite some comparable negative product mix in ESG and Microwave Products and FX headwinds in our businesses that are materially exposed to Europe, predominantly Markem-Imaje, digital printing and VSG.

Next slide. The Fluids segment posted organic growth of 9% for the quarter, but the majority of the portfolio posting comparative top line growth with particular strength in our fueling and transport businesses. Consolidated margin for the segment was flat, largely as a result of the dilutive impact of fueling systems to segment margin and some transitory footprint issues in our transport business, which should be largely contained in Q3.

Our pumps and process solutions business has all performed well during the quarter. Incremental margin performance in PSG, Maag and Precision Components were all in excess of 50% in the period as a result of volume leverage, mix pricing and cost control initiatives outweighing input cost headwinds and tariff costs on imported components. Colder continued to perform well in the period in both the top and bottom lines as a result of solid demand in single-use connectors.

Fueling and transport had a choppy quarter from a margin conversion point of view, but we are encouraged in our exit margin for the quarter and our forecast for top line and margin conversion leading into Q4.

In Q3, DFS posted top -- solid top line growth. And while incremental margin performance was still below expectations, it was -- it has improved and leads us to be confident that the majority of our footprint consolidation costs are behind us and that we are headed in the right direction in meeting our margin objectives as we outlined in our September presentation.

In OPW, while our margin performance was satisfactory, we did have prior period footprint-related cost in the quarter and lost production time at our North Carolina facility as a result of weather-related issues.

Our Q4 forecast for Dover is largely driven by the expected improvement, margin conversion in the Fluids segment, particularly driven by our fueling and transport businesses, improving their operational performance and the beginning flow through of our cost control initiatives.

I've just returned from our facility in Dundee, Scotland, and while there remains much to do, I am confident that our line rates are set to improve through the quarter and will benefit from the industrial absorption and reduction in frictional costs. Of note, we are assessing the outlook for EMV demand in the U.S. in 2019 and would be making some decisions as to the appropriate level of components stock to be carried into January to support projected demand.

Moving on to Refrigeration & Food Equipment had its toughest quarter of the year in Q3 with segment revenue down 12% to $386 million. While we haven't been expecting another difficult quarter in retail refrigeration, we are caught offguard in our Belvac business where machine deliveries have increasingly deferred into 2019, negatively impacting our prior forecast for segment margin for the quarter and full year.

Our full year segment forecast now incorporates a more modest decline in demand and retail refrigeration as this business begins to bottom and a pushout of machine deliveries from Belvac into 2019, which are significantly accretive to margins in the segment. This negative mix impact will be partially offset by cost control actions undertaken in the year, largely in the retail refrigeration business.

This earnings miss in Belvac does not add an additional operational challenge to the group nor does it change the fundamental value of the business and the portfolio as it is a unique asset capable of delivering high but inherently lumpy returns. As we presented in September, we've began, in earnest, to address our footprint actions in the segment as it is the clearest path to improving margins to the target ranges that we established in the presentation. We expect to begin in Q4 and continue the project through 2019.

Going to the next slide. As we noted in the morning's earnings press release, we are progressing as planned in the rightsizing initiatives that we announced to our investor -- at our investor meeting in September. As you see in the slide, we are well on our way to concluding the reduction portion of the plan and you can see the reconciliation of the P&L impact of both the restructuring charge and the SG&A cost reduction in Q3 and the projection of the timing of the charges for the balance of the plan. The non-headcount portion of the plan will be almost exclusively weighted towards 2019, and I think that Brad addressed converting these charges into cash. We can deal with the Q4 charges and what do we project on that cash impact in the Q&A.

Moving on to the next slide is the guidance, which I addressed in the press release and my comments on this segment outlooks. To conclude, we enter Q4 with good order backlogs across much of the portfolio which has weathered the challenges of higher input cost in an uncertain global trade environment during the year. Clearly, there remains much to do to deliver on our full year guidance. But by acting decisively on our cost structure, we are in a good position to deliver. I have been encouraged by the engagement of our leaders to embrace these changes, and I'm looking forward to embarking on the next stage of our initiatives and our objective of delivering best-in-class operating performance.

That's it. Let's move on to Q&A.

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

Thanks, Rich. (Operator Instructions). So let's have our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Andrew Kaplowitz of Citi.

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

Rich, at the Analyst Day in September, you mentioned you're starting to see some stability in pricing within refrigeration. You kind of did talk about it in the presentation today. You had also mentioned some interesting new products coming out. Obviously, you have the Belvac delays there, but margin was lower than most of us thought. So can you -- is it too early still to call a bottom there and can you keep up with the cost? Can you use cost to keep up with the volume declines as we go into 2019?

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

Okay. Well, I think that we need to bifurcate the answer between the headwind on Belvac that is really going to move into 2019. That's going to cost us about $10 million in comparable profits to Q4 last year. We're not worried. As I've mentioned, I'm not worried about the business overall. The backlog is there. It's just that these are pretty lumpy revenue and returns and the margin on the Belvac volume is quite high. So we're going to have to make up that particular headwind on that basis from that with cost control actions or the aggregate of the cost control actions. On retail refrigeration, we haven't really seen a positive pricing environment, but I think that early data shows that some of the negative pricing pressure that we saw in the first half of the year has begun to moderate. I don't think we're prepared to call the bottom. But at least from what we can see in backlogs going into Q4, clearly, the market started slowing down at the end of last year so the comp gets better, but the rate of decline in terms of the backlog is significantly smaller than what we've been seeing all year. So I don't think we're prepared, right now, to say we're at the bottom, but I think the data would show that the decline has come down quite a bit and that the pricing headwinds have moderated some. We're going to really move our -- from our decision-making process going into next year is really going to be to call the size of the market, and that's what's going to drive the cost takeout from a footprint point of view. But that's really a full year project that is going to take us to do it. So I'm -- look, I just don't think it's getting that much worse going into '19, but I don't have any indicators that say it's going to be better in '19 other than the fact that I think that we will benefit from the -- through the year cost takeout when we start doing the comps going into 2019.

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

Great. And then, Rich, maybe can you give us more color into the revenue growth across the company? Obviously, you talked by geography, U.S. is flat. We know its refrigeration sort of holding that down. Asia, up 23%. Obviously, there's a lot of concern out there on the macro side into China and Asia, but it doesn't seem like you guys are seeing it. So maybe talk about the visibility you have into the geographic growth as you go Q4 and into 2019.

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

Look, clearly, the North American market is the leader in terms of the demand, but in our exposure to Asia overall is relative -- it's not overly material. But right now, the demand that we've seen in -- particularly in China, has kept up. A lot of that is in the underground portion or the OPW portion of the business right now. North America, I think, it's a couple of different tales at the end of the day. I think the CapEx-levered businesses that we have are posting good top line growth. I think if you go through some of the comments that I wrote in the press release about who's clocking it double-digit growth, I mean, we can go through it again, but I mean fueling systems is close to 15 for the quarter. So I mean, that begs the question of what's going to happen to EMV, so we'll leave that to a follow-on question. But overall, GDP in North America is up and it's driving the CapEx end of our business. I think that Markem-Imaje is just performing in the sector, so its growth was close to 5% for the quarter. So it's clocking quite well. And then as I mentioned, the margin conversion on those businesses has been excellent.

Operator

Your next question comes from the line of Steven Winoker of UBS.

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

Just a couple of questions. One, just because you chit it up, so what was EMV growth in the quarter? What are you seeing in terms of trajectory there and how are you thinking about that going forward?

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

I will put it in percentage terms, but EMV grew during the quarter approximately 5%. The expectation that, that same rate will continue into Q4. I think that our view is U.S. demand, EMV-driven demand, however you want to describe that between kits and full units is going to be up next year. I just don't think we're prepared to put a quantum on it yet, but clearly it's going to be in our 2019 guidance. So I mean, it's coming -- the decisions that we're trying to make is how much inventory to lay in, as I said in my comments, how much inventory to lay in to be prepared if we get a big flex at the beginning of 2019.

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

Okay. Good to hear. And then I just want to follow up that Belvac commentary as well simply because I -- if we go back and listen to the comments from last quarter, at that time, it was pushed and the thought was, look, it's back end-loaded to Q4. The expectation was that it will remain. So specifically, it's always easy for a lot of companies to say project push out for large projects. Can you give us a little more comfort level that, that -- what's going on here and why it's sort of just one more quarter and we can then put it in our numbers for Q1?

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

Yes. Look, I mean, I think that we're pretty transparent. We are caught off guard by it, right? We had the backlog and we are moving into beginning to source, and we did source some of the raw mats to actually get into building out some pretty large units. The deliveries have been deferred. Now what does that mean for 2019? Is it additive? I think it's too early to say. But I think that what we believe is what we had in the pipe. We're going to deliver in 2019. But I mean, look, these are very big machines, so they got big ticket prices on them and they have very high margins. I'm as pissed off as everybody that the fact that they got -- but I don't believe that it's something that's changed in terms of the market structure that -- you know what I mean, that some reason that the retail -- what would it be called? Retail food for beverage is rolling over by a stretched imagination.

And our customers there aren't -- a lot of times, retail beverage, they're some of the canning makers themselves. So I don't think it's overly worrisome. I just think that the timing of it is poor and the fact that it happened in a sector that we've already had headwinds in makes it doubly poor, but I think it's still a good business and I would expect that we'll deliver on that volume that we should have in 2019.

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

I would just add to your comment earlier. We'll have more to say about this in January '19. But I would not, at this stage, think that it's an automatic ship in the first quarter. We'll come back on the timing of that. I would expect it to be slightly later than that or later than that.

Operator

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

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

Just, Rich, wanted to think a little bit more about the puts and takes in a little more detail, and the Belvac color is really helpful. If we think about, I guess, you've got roughly $24 million of restructuring tailwinds and the numbers here in 2018, should we think kind of the -- most of the kind of missing upside, for lack of a better term, is just price cost? Can you give us a little color on price cost in the quarter and what you're dealing with there and any kind of price encounter actions that you're taking?

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

Well, I think, as I mentioned in my comments, I think that both the Engineering Systems group and Fluids grew performed as we expected. I think at the end of Q2, I made some comments that if you looked at the trajectory of earnings in Engineering Systems that you couldn't just clock that through the balance of the year because of the fact that we knew that Q3 was going to be little bit light to that trajectory. Now having said that, the incremental margin on that revenue is still significant. So it's not by any means a bad performance, it's just that we expected that to happen to a certain extent. On Fluids, I think the growth rate is still very good, but it's a little bit of the same story that we've had year-to-date in terms of the margin conversion on the DFS portion of the business. It actually exited quite well in the month of September. And that's why in our full year forecast, a lot of our operating performance, at least our comparable operating performance year-over-year, is going to be driven by Fluids into the quarter.

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

And then I was also curious, I think you said the footprint restructuring is now actually done in fueling. I was thinking that was more of a 2019 exercise, is that correct? And...

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

No, no, no. What I was saying is that we've been carrying around the cost of the Dundee consolidation, the Europe -- the first piece of the European footprint, which never went into restructuring, we've been taking that through the P&L all year. That is largely complete, right. So that's where I was last week. Look, we're not getting into the gory details. I mean, line rates are picking up. The absorption is picking up. And without getting into monthly margins, if I look at our September margin in DFS, they've moved up significantly. So it leaves us to feel good about the fact that that's where we have a lot of demand going into Q4. If we can convert the September margins, we're in pretty good shape.

Operator

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

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

My first question, I guess, is on the free cash flow. I saw the detail on restructuring and so forth. But working capital has been a big drain in the first 9 months, $160 million or so of cash out. So I just wondered how quickly we should expect that to reverse and whether one should expect a much better performance on that next year?

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

Well, I think that Brad said in his comments that we expect to be within the range that we gave as a percent of revenue in the September presentation. It's going to, clearly, going to take some heavy lifting to get there, but we think we're confident that we can get inside the range. In terms of 2019 performance, well, if I take out the restructuring, the cash impact on the restructuring, that's going to depend on our guidance for top line revenue, right? So I mean, again, we're building net working capital, which is pretty much inventory receivables on the back of top line growth. Refrigeration is just not large enough to offset that, so we're liquidating inventory on the refrigeration side because revenue is coming down. But then, conversely, we've been building inventory on some pretty good growth rates on the balance of our business. We are not clocking at best-in-class cash flow, clearly, so there's a lot of work to be done. But before we start giving '19, I think that -- I'll put it this way, in '19, we'll be in the range that we gave you in September. How that dynamic functions is going to be a question of once we call growth rates for 2019.

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

And then just circling back maybe one more time to RFE. Are we right in thinking that, this year, the adjusted profit is sort of about $150 million for that business? And then, yes, if you do or don't want to give color around that, maybe related to it, how quickly you think we'll start to see footprint consolidation savings next year in that business?

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

Let's not -- look, I won't answer the question about the segmental margin expectation other than the fact I did give you some color on the quarter-to-quarter, it's going to be a $10 million negative impact because of Belvac year-over-year. So that's something that we're going to have to make up. The footprint optimization, it will begin in Q4. It's not going to be overly material. I think that the bigger, in terms of its positive impact in 2019 -- but we'll give you the color around that when we make the formal announcement, I think that the bigger positive is going to be the fact that we've taken out a significant amount of overhead out of that business all through the year, right? So we've been rightsizing as we've gone down and we have flat revenue. We're going to get the benefit of the full year benefit of taking that out. The larger footprint issues are going to take throughout 2019 because these are pretty large endeavors in terms of a lot of automation and then dealing with the actual physical footprint.

Operator

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

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

Just a fairly simple question. Given that you sort of started cost cutting in Q3 and Q4, back on September 11, you said $0.53 of net benefit in 2019. Everything -- can we assume that everything you have done, so far, is consistent with that framework?

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

Yes.

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

Okay. So still -- so those numbers still stand. And then the second question on sort of timing of restructuring in Refrigeration & Food Equipment and also you talked about footprint. Looking at the Q, there was just not a lot of restructuring in that business. And I understand that Belvac was part of it, but should we think that this restructuring is sort of the timing here is related to sort of the timing of footprint rationalization as well? Is that the way to think it? Just thinking about the timing of what's going on in that cycle.

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

Yes and no is the answer to that question. If you go back and look at the presentation in September, there wasn't a lot of restructuring in that particular segment because management had been taking out cost all year as the revenue had gone down. So there was not a lot of low-hanging fruit per se. There is some restructuring that comes along with the footprint actions and -- but there isn't any kind of residual structuring that we're just waiting on timing in terms of refrigeration. It's overly material.

Operator

Your next question comes from the line of Deane Dray of RBC Capital Markets.

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

I'd like to go, Rich, to your comment on seeing competition in inks in Markem-Imaje. And I don't think I've heard this before because you do make your own inks and the whole kind of proprietary nature of your inks, you could only use your inks with your equipment. So how has competition in inks cropped up into this business?

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

Yes. Well, I should have been more specific, so I apologize. That was a comment about our JK business that is part of digital printing. That is not a comment. I think the comment I made about Markem-Imaje's performance and its incremental margin was because it was driven by consumables, which is largely ink at the end of the day. So no issues in terms of that side of the business. The competition on inks is more on the digital print side.

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

Okay. That's really good to hear. All right. And then maybe just a broad question about the footprint reductions that you're facing. And a lot of questions about like in retail fueling, you're cutting back on inventory. What about the other side to this? Are you going to step up and build some buffer inventory to avoid some disruptions as you go through these footprint reductions?

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

That's 2 different questions. Number one, we're actually carrying more inventory than we would like in retail fueling. Some of that is based on the fact that the top line growth has been robust, but it's very much impacted by some of these footprint consolidation work that started last year.

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

In supply chain.

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

Right. So I mean, this whole closing of Malmö and moving to Dundee, you're basically transferring a significant amount of working capital that takes longer to grind through the system. So we're not -- we're actually not happy about our performance right now. It's understandable, but we're not pleased with it. The comment I made about inventory in DFS is it's a question of how much can we clear out operationally. We've got a good backlog so we should be able to perform in Q4 and consume a lot of that kind of operational inventory, but we really need to make a decision about EMV for 2019 and we don't want to get caught off guard. I don't want to be sitting here at the end of Q1 saying that we've got frictional costs for expediting in air shipments because we didn't have enough kits in place to support the demand of the EMV. Right now, we're not entirely sure what the pace of the start off in EMV is going to be in 2019, but I'm reasonably sure that we're going to be prudent and make sure that we carry some inventory into '19 that we can support whatever demand is there.

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

How about the buffer inventory? Just as a safety practice as you embark on this footprint reductions.

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

Yes. I mean, I think when we did -- when we do a material one, I think that would be part of the disclosure.

Operator

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

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

So just to clarify the free cash flow commentary a little bit. You said you're going to be within the range, but it's a little bit of a TBD. Should we just assume kind of the low end of the range, I guess, is what you were saying kind of the 8% range for this year?

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

I think you can assume that we'll be in the range, Steve. I can't get down to a level of granularity to say it's going to be 8.75% of revenue. I did not make...

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

Okay. And just to be clear, the $40 million of restructuring, that's about 50 bps of that headwind?

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

In terms of the cash flow headwind?

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

Yes. Just a headwind on the cash margin.

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

You know what? I haven't made that calculation. But I think that we can expect that...

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

40, you said, right?

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

Yes. Out of the second -- or the fourth quarter restructuring charge, approximately, I would say, 50% of that charge would be cash and the balance of it would probably...

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

We also have some carryovers. So I think the full year cash flow impact including Q4 is about $59 million, $60 million of cash.

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

There you go.

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

Higher than 50 bps if you want to do the math.

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

Okay. And then one quick one, just a follow-up on PID. You are doing, I think, some restructuring in PID, I would assume. Are any -- is any of that restructuring related to kind of sales and/or service?

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

No. It's far more back office. And you saw from our press release the other day about us open our digital center, part of that has to do with the fact that the -- of the transfer of some assets between Keene and Boston.

Operator

Your next question comes from the line of John Inch of Gordon Haskett.

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

So the Q called out weak refrigerated door case sales and it kind of implies that there's a remodeling aspect to this, which I think you might have even cited somewhere in the Q. Is this a new phase of segment weakness? It may not have as much impact because of it's just not a big as the other, but just trying to dovetail that with Rich's commentary around sort of pricing dynamics seems to be improving and getting closer to bottoming.

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

Okay. Well, no. I mean, nothing is really changed. I mean, the build-out -- so the greenfield build-out of new construction has been bad all year, right? But there hasn't been a lot of maintenance either. So in our forecast through the year, I think that we were reasonably accurate in terms of greenfield build-out by food retail. We knew that was going to be kind of weak, but we -- well, we did not expect it at the beginning of the year and we've kind of been riding it down all year is that a lot of maintenance cap or refurbishment CapEx has been deferred or is not done in '19. So the dynamic is the same, but the rate of the decline has moderated at the end of Q3 going into Q4. So it's really nothing new.

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

Do you think that maintenance gets caught back? I mean, is it -- what kind of deferral -- that's why I'm asking this question about the context of maintenance and sort of where we're at in the industry cycle. Is this somehow would have been normal to expect or is it something that's new? It may not be that impactful, but it's still new suggesting industry troubles are going to go on for a while.

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

Hard to say right now. My best guess is we're bottoming right now. So worst-case scenario, it's flat in '19. Better case scenario, the maintenance portion of the spend starts to move back up.

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

50% -- it was almost 50% variable contribution margins in ES. Is there a mix angle that's driving such a big op profit improvement in that segment to drive the margins? Like what's sort of behind the number to cause for that result?

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

It's a combination of good mix and good operational performance. I think that we've got certain businesses that have done well, pricing in excess of input cost headwinds. Our CapEx-levered businesses, some of our highly engineered products. And as such, the margins on that volume are very good.

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

Just one last one. As you've gone through this third quarter into fourth quarter restructuring, some companies as they go through these restructuring programs, the more they cut, the more they realize they can cut. And I'm just curious, where we are today versus your expectations when you started, are you seeing as much more -- I mean what's sort of the feedback as you think about the opportunities that maybe the opportunity set to go after maybe even some more overhead cost out than you had previously talked about?

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

I think it's a little bit too early to talk about more overhead cost. What I can tell you is that I'm proud of the management team here embracing the challenge to take the cost out because it's just not easy. But I think that there's a belief that we have a plan in place that allows us to take these cost out while reinvesting in those platforms to make the businesses stronger.

Operator

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

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

So Rich, it looks like pricing got a lot better this quarter than it has been the previous 2 quarters. Just maybe talk a little bit about how much of that is tariff related versus tier pricing that you're getting and like how should we be thinking about that number moving forward over the next couple of quarters?

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

It's not materially better pricing. I think it's much more weighted towards mix than price overall. I think that by and large, I think that we've done reasonably well in terms of price. Some operations are better than others based on kind of the backlog and uniqueness of the product, but there's not a lot of price. I think that there's -- you see volume leverage coming through and you see better mix coming through more than price. I mean, there's a little element of price, but net of all cost headwinds it's a relatively immaterial number.

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

Okay. All right. Yes, it just seemed like it gotten a little bit better just based on the Q, but that's okay. Maybe just following through on like the Belvac discussion. So recognize that Belvac surprised you guys, I'm just curious like what are your customers saying? Are the deferrals related to tariff-related concerns? I'm just curious if there's any additional color there.

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

Yes. I mean, it ends up being a dog's breakfast. There's a variety of different reasons. They're all rational. Their timing in terms of build-outs for their own footprints. I think that there is an element of kind of macro that's embedded there to a certain extent. It's been -- some of it -- a lot of this volume is international volume and you've got a variety of noise out in the system, which I think is making people a little bit more deliberate in terms of their own CapEx plans. I think that the projects are impacted overall, but I think some of it is caught up in that kind of general macro noise.

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

Got it. And if I could maybe just quickly clarify Andrew's comments from earlier. With the restructuring benefits that you have coming through from the rightsizing this year, so I'll call it roughly $24 million. The investment right now is all going to happen in 2019, right? So the incremental benefit should be around $0.39, is that right?

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

Well, look, I mean, I said -- we said it was a gross of 130, right? And out of 130, let's round here, 25 gets picked up in 2018, right? So it's a rolling 12 on 130, so we're tracking right along. What I said about '19 is, if you go back and look at the presentation, a percentage of it is headcount related.

That's the part that were substantially complete. The balance of it is the consumption of SG&A by that headcount to a certain extent just to kind of broad based say. That, you get in '19, right? So the full effect of that portion is in '19.

Operator

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

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

Just to go back to your previous comment, Rich, about the pricing. At the end of Q, you closed out 1.1% pricing, which is pretty decent. It's certainly a lot better than last quarter. Is that a price mix number or is that pure price?

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

Yes. It's a price. It's a pure price, right? But it's a pure price net of input.

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

Okay. Okay. I'll clarify with Paul if that's -- what I mean...

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

That's earnings.

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

But 1.1% is not bad.

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

Are you talking about the revenue? The revenue side, right?

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

Going back to the earnings, that's pure price.

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

So that's pure price, okay.

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

That's not mix.

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

Yes. And the revenue side, it's pure price. On the EBIT side, it's a net number.

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

As we said, it's slightly better than what we expected going into the third quarter. Material costs are up slightly, too, so the net-net is it puts us in the same position we were before. That's the way I think about it.

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

So my question was really, is that 1.1%, is that fully loaded or were there some price increases that came through at the end of the quarter that makes 4Q better than the 1.1%? Or is that a good run rate from here?

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

No. I think that's a good run rate because our businesses have been added for a while and we're seeing good momentum in certain of the businesses which have the higher input costs, and I feel like it's pretty stable going into the fourth quarter.

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

Okay. That's helpful. And then, Rich, some comments you made, some more comments which I thought was interesting. You mentioned that you saw some dealer stocking, I think that was in DESTACO, but did you see a little bit broader dealer stocking during the quarter? And then you mentioned, I think, there's a weakening in Europe going to 4Q. Just maybe pick up on those, right.

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

Sure. Well, I mean, look, we've got businesses that are, in certain cases, 80% of the revenue goes through distribution. So you can't really see the retail customers. So our revenues are 2 dealers at the end of the day. So dealer stocking is not necessarily a bad thing because of the fact our dealers only stock based on their projection of demand. So overall, I mean, we're talking about some of the smaller businesses like TWG and OKI, I mean, I wouldn't be worried about kind of that -- that we're kind of pushing into dealers and that we're going to have to pay the price for that. I think it's more of a positive comment of some of our businesses that sell through distribution. Our network is positive and they're trying to get their hands on what we make. And then the second part of it was more of an FX-related comment, right? So quarter-over-quarter, there is a headwind on the euro. I think Brad kind of cleared -- went through the trajectory of it. And based on -- I think we used a $1.19?

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

$1.17.

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

So there is a headwind, at least in the way that we're forecasting on our European levered businesses, which is largely more a revenue issue than anything else.

Operator

Your next question comes from the line of Mic Dobre of Baird.

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

Just looking at your Slide 13, the rightsizing update. I realize this is a little bit nitpicky, but your mix of gross savings has changed a little bit. Can you maybe give us some color as to what's driving that, especially at segment level?

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

Yes. I don't think it's a change at the segment level. I think if you notice on the cost side, there's a little bit of cost now associated with corporate. Well, that's driving a little bit of the benefit side as well. So just a minor change.

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

I got you. Okay. And then just making sure that I understand this correctly. Back to RF&E, so if we're looking at '18 and what carries into '19, you're essentially saying that you've got $10 million of Belvac contribution to operating income that switches in '19 and you've got the savings from the rightsizing here that you detailed on this slide. That's another, what, call it $10 million incremental, so that takes us to $20 million. Is there something else that we should be aware of in terms of specific drag that you had in '18 that will no longer be there in '19 or anything else that kind of helps us make that bridge?

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

I think that's enough for now.

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

All right.

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

I mean, we'll do it when we close the year and we give the kind of the guidance overall. We'll give you the color of what we think about '19. But right now, you've got your fingers on the 2 pieces, right? It's the cost takeout in '18 and the Belvac mix that you can kind of roll forward.

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

Well, then maybe humor me with one more. The Q mentioned impact from Section 301 tariffs on ES and Fluids, I'm wondering can you sort of detail what the magnitude has been and what the drag would be going forward?

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

You know what, I've got a big spreadsheet in front of me. I can tell you right now that we're covering it through productivity and price, so I don't believe it's a drag. If it's specifically about RF&E, I'm not aware of any material exposure to imported components on that particular segment.

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

On 301, yes. Certainly, on 232, which we've talked about before, but again we'll have to see how that progresses it into '19. But at this stage, Rich is correct. I mean, it's not a big number on 301 for us. We don't ship a lot of product out of China into the U.S. And at this stage, it's being covered to productivity.

Operator

Your next question comes from the line of Nathan Jones of Stifel.

Nathan Hardie Jones - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

I've got one more on the Belvac push out. I think Brad said don't expect that to ship in the first quarter, so these shipments have now been pushed out probably close to a year. Do you have contractual protection against cancellations in this? How do you feel about the potential for those orders to not ship to the right -- to actually go away? And what gives you confidence that, that won't happen?

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

There is an amount of progress billing once we start the engineering and the procurement phase, so I don't expect a double negative on an additional push out. And look, and crystallizing that backlog into orders, I think that Brad was right to say, look, we believe that it's going to roll into '19, but let's be careful. It's not as if January 1, we're going to kick it off and we expect a big comparable bump on the segment in the first quarter because of that translation, right? We believe we'll get it during the year. It's unclear right now when we kick it off.

Nathan Hardie Jones - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

My second question is on pump and process business. I think during your comments you said that, that part of the business realize incrementals above 50%. Demand has been pretty good for a while. Can you talk about what's driving those high incrementals in terms of improved pricing in the market versus your internal initiatives, that kind of thing?

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

I think that answers ends up being incredibly granular. I think that, overall, it's a combination of volume leverage because the revenue has been moving up in this segment having a direct impact. I think that the fact that they've got in front of their input cost headwinds that they're either positive or net neutral has an impact, and then demand is there. So I mean, so then just pure volume. That's not kind of absorption. Not the absorption impact of it. So it's a combination of all those. In certain businesses -- and then you've got companies like Precision Components that the nature of that business when it's up, it's highly engineered products, so the margins on some of those products is very good. And we've got particular strength, as I mentioned at the end of Q2, in our Hydro or Colder business that we're expanding the footprint of that business because demand has been great and the margins are very accretive to the segment.

Operator

Your final question will come from the line of Charley Brady of SunTrust Robinson Humphrey.

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

Just a couple of quick ones for me to finish it off here. On the -- so on DFS, you commented back in the Analyst Day an exit rate of 15% to 17%. I just want to go back to your earlier comments on how that is performing. And without getting too granular, it sounds like it's maybe getting a little bit better, faster than you had originally anticipated.

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

I think it's not better and faster. I think that we're just happy, right? We've been dragging that around for the full year. I think the team has worked really hard in a pretty bad situation that we had in terms of that consolidation in Europe. But I -- they've ground through it and we see ourselves coming out on the other side so we don't have a lot of negative. It wasn't just the consolidation in Europe, it's the -- it's when you can't get the throughput out of that facility, you're making it up in other facilities, which is it got supplier premiums and air freights so there's a lot of kind of additional frictional costs in the system. That's all coming out because, I think, that Dundee has got their feet on the ground now and you couple that with a -- the demand of EMV coming up and EMV products, if you will, are beneficial to margins of the group. So we like what we saw of our exit margins in Q1. And if that leads us in some amount of confidence in going into Q4 or meeting our objectives because from a year-over-year basis what we're looking for is a lot of the year-over-year profit change is going to come out of that particular segment.

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

Helpful. Just one more. On OPW, you commented on the weather impact, obviously. Can you quantify the material on the last few days on the margin perspective? And [outdoor] comes back, but maybe can you quantify that?

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

Yes. I mean, I don't have that number in front of me. It's not overly material. I think the bigger issue that OPW had just on a quarter-to-quarter basis was some footprint consolidation cost that they had started before kind of we announced this new initiative, right? This is something that's been going on all year. They finished it up and then they took some charges in the quarter, which weren't helpful. But I think, like I said, it's largely contained into Q3, so our expectation is that OPW's margins in Q4 are going to be good.

Operator

That concludes our question-and-answer period. I would now like to turn the call back over to Mr. Goldberg for closing remarks.

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

Yes. Thanks very much for joining us for the Q3 earnings call. We look forward to speaking to you again next quarter. Have a great day.

Operator

Thank you. That concludes today's Third Quarter 2018 Dover Earnings Conference Call. You may now disconnect your lines and have a wonderful day.
