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DOV - Q3 2016 Dover Corp Earnings Call

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OVERVIEW:

Co. reported 3Q16 revenue of $1.7b and EPS of $0.83. Expects full-year 2016 total revenue to decrease 4-5% and EPS to be $3.00-3.05.

CORPORATE PARTICIPANTS

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Bob Livingston *Dover Corporation - President and CEO*

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CONFERENCE CALL PARTICIPANTS

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

Joe Ritchie *Goldman Sachs - Analyst*

Andrew Kaplowitz *Citigroup - Analyst*

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Nigel Coe *Morgan Stanley - Analyst*

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Julian Mitchell *Credit Suisse - Analyst*

PRESENTATION

Operator

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

(Operator Instructions)

As a reminder, ladies and gentlemen, this conference call is being recorded, 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 Goldberg - *Dover Corporation - VP of IR*

Thank you, Paula. Good morning and welcome to Dover's third-quarter earnings call. With me today are Bob Livingston and Brad Cerepak. Today's call will begin with comments from Bob and Brad on Dover's third-quarter operating and financial performance, and follow with an outlook for the remainder of 2016. We will then open up the call to questions. As a courtesy, we kindly ask that you limit yourself to one question with a follow-up.

Please note that our current earnings release, Form 10-Q, investor supplement, and associated presentation can be found on our website, dovercorporation.com. This call will be available for playback through November 2 and the audio portion of this call will be archived on our website for three months. The replay telephone number is 800-585-8367. When accessing the playback, you will need to supply the following access code: 8853-5285.

Before we get started, I would like to remind everyone that our comments today, which were 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 Forms 10K and 10-Q 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. With that, I'd like to turn the call over to Bob.

Bob Livingston - *Dover Corporation - President and CEO*

Thanks, Paul. Good morning, everyone, and thank you for joining us for this morning's conference call. Our third-quarter results were disappointing, as the continuing weak macro environment, further declines in longer cycle oil and gas applications, and production inefficiencies in our retail refrigeration business impacted both volume and earnings. These results were well below our expectations and more than offset solid improvements in our upstream drilling and production businesses, as well as continued strong performance in our printing and identification platform.

From a geographic perspective, our US and China activity declined organically, both sequentially and year over year. On an organic basis, our European markets improved sequentially and year over year.

Within energy, revenue was up 5% sequentially, largely within our drilling and production markets. This improvement was driven by increases in the North American rig count, principally in the Permian. The recent trends in rig count and oil price are constructive and supportive of continued near-term improvement in our early cycle businesses. That said, within this segment we continue to be challenged in longer cycle applications.

Engineered systems organic growth of 1% was driven by another strong quarter in printing and identification, which posted organic growth of 5%. In the industrial platform, organic revenue declined 2%, though our vehicle service equipment business had a very strong quarter.

Fluids posted 17% revenue growth, driven by acquisitions. However, our organic revenue decline of 9% reflects activity reductions in our businesses with longer cycle oil and gas exposure, as well as tough comps. Lastly, growth in retail fueling was less than anticipated, while our businesses serving the hygienic and pharma markets continue to show very strong growth.

Refrigeration and food equipment revenue declined 2% organically, principally driven by tough comps and can-shaping equipment. Margin performance was well below expectations at Hillphoenix, primarily driven by production challenges in case manufacturing. We continued to implement changes to improve the business.

Regarding acquisitions, we have closed two deals since our last earnings call, both in engineered systems. We added a small automation and data analytics business, and also acquired a European lift business. The addition of the lift business gives us a $500-million platform in a growing vehicle service equipment market.

We also recently announced that the Wayne acquisition, due to an extended regulatory review in the UK, will now likely close in the first quarter. Our teams are actively exploring measures to satisfy the regulators' concerns as quickly as possible. This matter relates only to the UK dispenser business, which is very small in the context of the transaction.

Now looking forward. Within energy, we are encouraged by the recent improvements in North American rig count and oil prices, and believe both are constructive for continued near-term improvements in our business. That said, we anticipate our longer cycle oil- and gas-related businesses to remain sequentially flat.

In engineered systems, we anticipate activity in our industrial platform to remain soft due to a challenging macro industrial environment, as well as from activity deferrals, as some customers push out order delivery into 2017. We expect our printing and ID platform to have strong growth.

Fluids' overall growth will be less than we expected in our prior forecast, driven by continued week, longer cycle oil and gas markets, as well as CapEx reductions by integrated energy customers. We expect the strong growth we have seen in our hygienic and pharma markets to continue.

Finally, within refrigeration and food equipment, we expect customer spending to slow as we close out the year. We also expect margin challenges to continue as we work to improve manufacturing at Hillphoenix. With that, I'd like to turn it over to Brad.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Thanks, Bob. Good morning, everyone. Let's start on slide 3 of the presentation deck. Today we reported third-quarter revenue of $1.7 billion, a decrease of 4%. This result included an organic revenue decline of 7%. Growth from acquisitions less dispositions was 3%. EPS was $0.83.

Segment margin for the quarter was 14.1%, below last year, largely driven by lower revenue and the impact of acquisitions and production inefficiencies. Bookings decreased slightly from the prior year to $1.7 billion. Within this result, acquisition growth of 6% was more than offset by the combined impact of reduced oil and gas markets, dispositions, and FX.

Organic bookings in engineered systems grew 5%, refrigeration and food equipment grew 6%, while energy was down 22% and fluids decreased 9%. Overall, book to bill finished at 0.99.

Our backlog increased 4% to $1.1 billion, or 1% organically. Free cash flow was $189 million for the quarter, or 11% of revenue. We remain on track to generate free cash flow of roughly 11% of revenue for the full year.

Now let's turn to slide 4. Engineered systems' organic revenue increased 1%, reflecting solid growth in printing identification, partially offset by soft industrial markets. Refrigeration and food equipment declined 2%, driven by tough comps in can-shaping equipment and softer customer spending in retail refrigeration.

Fluids' organic decline of 9% was largely driven by upstream and midstream oil and gas exposure, tough comps, and a lower-than-expected growth in retail fueling. Energy organic revenue was down 24%. As seen on the chart, acquisition growth in the quarter was most prevalent at fluids, with 27%.

Now on slide 5. Energy revenue of $273 million decreased 25%. On a sequential basis revenue increased 5%, driven by our upstream drilling and artificial lift of businesses. Earnings of $13 million included restructuring costs of $5 million. Adjusting for these costs, earnings were $18 million and margin was 6.8%, in line with our expectations and sequentially improved.

Third-quarter order activity remains positive and we believe we are our track to exit the year with margin near 10%. Bookings were $271 million, a 10% sequential improvement. Book to bill finished at 0.99.

Now on slide 6. Engineered systems revenue of $571 million was up 1% organically. Earnings of $97 million decreased 5%, principally reflecting the impact of a disposition and also impacted by business mix.

Our printing identification platform revenue of $253 million increased 11%. Organic revenue was up 5%, reflecting solid global marketing in coating and strong digital printing activity. Acquisitions added 7% growth.

In the industrial platform, revenue was $317 million, which included an organic decline of 2%. The organic revenue decline was fairly broad-based and also reflected activity deferrals into the first quarter at Environmental Solutions. Margin was 17%, an 80 basis point decline. Bookings of $580 million were up 3%, which included organic growth of 5% in both platforms. Book to bill for printing identification was 0.98, industrials' book to bill was 1.04; overall, book to bill was 1.02.

Now on slide 7. Within fluids, revenue increased 17% to $413 million, while earnings decreased 12% to $66 million. Revenue performance reflects 27% growth from acquisitions, partially offset by a 9% decline in organic revenue. The organic result was driven by declines in our longer cycle upstream and midstream oil and gas businesses and tough comps, reflecting $18 million in project shipments last year that did not repeat.

In addition, spending from certain integrated energy customers, particularly in retail fueling, was lower than anticipated. This decline was partially offset by very strong results in our hygienic and pharma markets.

Margin declined 530 basis points, reflecting lower organic volume and the impact of acquisitions and deal costs. Bookings were $414 million, an increase of 16%. This result primarily reflects the impact of acquisitions. On an organic basis, bookings declined 9%. Book to bill was 1.

Now let's turn to slide 8. Refrigeration and food equipment's revenue of $451 million included an organic revenue decline of 2%. Earnings of $64 million declined 16% from the prior year, largely driven by production challenges at Hillphoenix, the impact of the disposition, and product mix.

The organic revenue decline was largely driven by tough comps in our can-shaping business. Margin was 14.2%, 140 basis points below last year. Within this result, production inefficiencies at Hillphoenix were $6 million, or about 130 basis points of the decline.

Bookings of $429 million were flat year over year and included organic growth of 6%. Organic growth was largely driven by strong order activity in our can-shaping business, which will be shipped in 2017. Book to bill was 0.95.

Let's go to the overview slide on page 9. Let me cover some highlights. Corporate expense was $27 million and net interest expense was $33 million, both largely in line with expectations. Our second-quarter tax rate was 28%, generally in line with expectations. CapEx was $43 million in the quarter.

Now moving to slide 10, which shows our full-year guidance. Our 2016 revenue guidance has been adjusted to reflect reduced forecasts. We now expect total revenue to decrease 4% to 5%. Within this estimate, organic revenue is expected to decline 7% to 8%. We continue to expect acquisitions will add approximately 7% growth, partially offset by dispositions and FX.

From a segment perspective, energy's organic decline is essentially unchanged from our prior guidance. We continue to expect further sequential revenue improvement into the fourth quarter.

Fluids and engineered system's full-year organic revenue forecast have both been reduced 2 points. We now expect fluids to decline 6% to 7% and engineered systems to be flat to 1% growth for the year.

Refrigeration and food equipment organic revenue has been lowered 3 points and now is negative 1 to flat. With regard to margin, we now expect adjusted margin to be around 14.1%. This excludes restructuring in deal and other costs.

Turning to the 2016 bridge on slide 11. Let's start with 2015 adjusted EPS of $3.63. We expect the year-over-year impact of lower restructuring cost in 2016 to be about $0.05. Performance, including changes in volume, productivity, pricing, restructuring benefits, will impact earnings $0.73 to $0.71. This is reduced $0.38 at the midpoint from our prior forecasts.

Increases in investment and compensation will impact earnings $0.11 to $0.09, reflecting a roughly $0.09 reduction from our prior forecast. Acquisitions less dispositions is $0.05 lower than our last forecast, reflecting the impact of our recent acquisitions and also softer retail fueling activity. In total, net acquisitions will be about $0.07 accretive.

Lastly, to combine impact of interest, corporate expense, and the tax rate has been adjusted $0.01 from our prior forecast. In total, we expect 2016 EPS to be $3 to $3.05, down about $0.38 at the midpoint from our prior guidance. Approximately $0.06 of this reduction is attributable to incremental fourth-quarter deal and restructuring costs. With that, I'll turn the call back over to Bob for some final thoughts.

Bob Livingston - *Dover Corporation - President and CEO*

Thanks, Brad. As I look back over the last 18 months, our results certainly haven't been up to our expectations. That being said, I don't want to lose sight of the many positive achievements our businesses have made over this time.

In energy, we effectively managed through a cycle that saw US rig count drop from 1,200 to 400 in six quarters. Through this downcycle, we streamlined our business while maintaining strong service levels. We are now very well positioned to service our customers as activity in North America upstream markets improve.

In engineered systems, we have expanded our printing and identification platform, which has historically been a strong performer. Our industrial platform has also performed very well over the last few years, though facing some tough comps this year. I am excited about what we have done in this segment, especially with our recent acquisitions.

Within fluids, we have built a strong plastics and polymer business. We are also in the process of building a world-class retail fueling business. Our fluids performance will improve through ongoing integrations and the addition of Wayne.

Lastly, in refrigeration and food equipment, we've done a good job diversifying our customer base and growing share with several customers. While this new business has certainly put stress on manufacturing, we have executed well on customer service, quality, and delivery times.

As previously noted, we have added scale in several markets where we see strong growth potential. In addition, we have further focused our business by divesting non-core assets.

In all, our recent acquisitions, combined with Wayne, will add over $700 million in revenue next year. These deals, together with a continuing recovery in upstream oil and gas markets and our commitment to improve margin, give me confidence we are on the right path. With that, I would like to thank our entire Dover Team for staying focused on our customers. Now, Paul, let's take some questions.

Paul Goldberg - *Dover Corporation - VP of IR*

Thanks, Bob. As a reminder, I'd like -- we have lots of people in queue, so I would like to remind you please, give one question with one follow-up. With that, Paula, if we can have the first question.

QUESTIONS AND ANSWERS

Operator

Your first question comes from Scott Davis of Barclays.

Scott Davis - *Barclays Capital - Analyst*

Hi. Morning, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Scott.

Scott Davis - *Barclays Capital - Analyst*

I'm trying to get a sense. I struggle sometimes to model you guys because when things come back, it's going to probably pretty darn good. But when energy comes back, is the incremental margin and I'm talking more on upstream stuff, is the incremental margin higher in 2017 than it was in the good years of, say, three years ago or is it lower? The reason why I ask this question is that does the restructuring mean that you get a higher incremental margin or does that get offset by a weaker price?

Bob Livingston - *Dover Corporation - President and CEO*

Well, I would start first by saying I don't -- with everything we're looking at with respect to our planning for 2017, we are not assuming that we're going to have price increases.

Scott Davis - *Barclays Capital - Analyst*

Yes, I'm just talking about do the decreases hurt you? I would assume prices are going to be down in your backlog, right?

Bob Livingston - *Dover Corporation - President and CEO*

Yes, we don't see further price degradation in 2017, Scott, but we surely are not planning on price increases. But to the heart of your question, with respect to the incremental margins in a recovery phase, I would say in the early months of the recovery, let's say at least the first six months, we are going to be quite diligent in not adding any costs unless they are absolutely required to service the customer.

So I think as we see a 10%, a 15%, maybe even up to a 20% increase in volume, we will not be adding the cost base back like we would have had in 2014. I think as you get beyond the flex point of the manufacturing capability, then you will see us adding some costs, but I think in the first few months of the recovery, you'll see incremental margins that will be quite attractive.

Scott Davis - *Barclays Capital - Analyst*

Okay. That's helpful. I know there's lots of questions so I want to ask a quick follow-up on Hillphoenix. What does production inefficiencies really mean? In my world, that means volumes are light and you didn't control costs, but does it mean something different to you guys?

Bob Livingston - *Dover Corporation - President and CEO*

Well, no. Actually, volumes aren't light, Scott. In fact, I was pretty pleased with the bookings at Hillphoenix in the third quarter. And I will tell you that, maybe I am being a bit cautious here, but the order rates, the booking rates here in October are coming in a bit stronger than we had anticipated for a normal fourth-quarter order run rate, seasonally strong.

So the production inefficiencies have nothing to do with the reduced volume. It's actually the complexity that we've added into the organization with many new customers and smaller product lots. And I will tell you that the fixes and the changes that we're making fall into two key areas. One is a little bit better integrity around our com bond releases, and a little bit better integrity around holding our productive schedules once they're released. That's been a challenge for the team over the last three or four months.

The guide we have in the fourth quarter, I would like to believe I'm being cautious with this guide with not only the segment, but specifically with Hillphoenix. But our guide for the fourth quarter does not assume any further improvements in our production variances beyond what we're running at in September. That said, we continue to work every week, every day, to improve the manufacturing flow at Hillphoenix. You want to add anything to that, Brad?

Brad Cerepak - *Dover Corporation - SVP and CFO*

No, I would just say that is a view versus our expectations, and year over year, the team continues to make progress. I would say -- the added piece I would say is that the production through the facility year- over year is not abnormal. What I mean by that is the production costs seem to be fairly in line; it's our expectations were much higher for further productivity.

Bob Livingston - *Dover Corporation - President and CEO*

I will give you a number. We measure this with respect to the production variances. The cost for us in the third quarter for these production variances at Hillphoenix was $6 million.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Okay.

Bob Livingston - *Dover Corporation - President and CEO*

It is a significant number.

Scott Davis - *Barclays Capital - Analyst*

Great answer. Thank you, guys. I will pass it on.

Bob Livingston - *Dover Corporation - President and CEO*

Thanks.

Operator

Your next question comes from Stephen Winoker of Bernstein.

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

Thanks. Good morning, guys. I want to stick on Hillphoenix for a while. I've been -- known that business for more than 15 years, and they were one of the few folks who were able to make money in this industry when so many others were bleeding. And a lot of that was the magic of the whole business model.

You're talking, I know, as you're making everything more complex or, sorry, as the customer mix is becoming more complex, that is one of the problems that the old guys always had before you took over one of them and others have struggled. So is this more than just a manufacturing, small manufacturing fix, but rather a whole design for manufacturability and broader fix? I am just a little more concerned at what I am hearing.

Bob Livingston - *Dover Corporation - President and CEO*

Well, longer term we are looking at, I would label it as product design opportunities, but that's not impacting our product flow today. It is just unbelievable how much the -- I will call it the mix complexity, has changed at Hillphoenix over the last six and nine months. And as we hit the seasonal ramp period here in late second quarter and in the third quarter, that complexity really did hammer us, Steve.

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

Okay. Well, we can maybe dive in later. But, and just on that point, you mentioned the $6 million production variance --

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Bob Livingston - *Dover Corporation - President and CEO*

And by the way, when you say Hillphoenix has always made money, look, we're still making money; we are just not to our expectations. I am not just saying my expectations, we're not operating at Hillphoenix's expectations.

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

Okay. Fair enough. Just so I'm clear, that's production variance of $6 million, is there any way to give us a thought for how much of the year-on-year negative impact came out of these inefficiencies?

Bob Livingston - *Dover Corporation - President and CEO*

Well, I think Brad, you shared a comment that margins were down 130 or 140 basis points. Actually, I think if you do the math, maybe 120 of the 140 decrease was the $6 million of production variances. Am I close on that number?

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes.

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

Okay.

Brad Cerepak - *Dover Corporation - SVP and CFO*

In the third quarter.

Bob Livingston - *Dover Corporation - President and CEO*

In the third quarter. We are talking third quarter, year over year.

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

Okay. I think I used up my follow-up question, so I will pass it on.

Bob Livingston - *Dover Corporation - President and CEO*

Thanks, Steve.

Operator

Your next question comes from Joe Ritchie of Goldman Sachs.

Joe Ritchie - *Goldman Sachs - Analyst*

Thanks, good morning, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Hi Joe.

Joe Ritchie - *Goldman Sachs - Analyst*

Not to belabor this too much, but just one last question on refrigeration and food equipment.

Bob Livingston - *Dover Corporation - President and CEO*

You're allowed.

Joe Ritchie - *Goldman Sachs - Analyst*

When do you think this gets rectified? And does your new production design allow you to then potentially stem share loss and potentially even gain share? How are you guys thinking about that?

Bob Livingston - *Dover Corporation - President and CEO*

Well, with -- your comment about share loss, I would say that one is behind us, because the -- you're referring to the loss of the business at Walmart, and --

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Joe Ritchie - *Goldman Sachs - Analyst*

Yes, I just look at your trends --

Bob Livingston - *Dover Corporation - President and CEO*

Beyond -- Go ahead.

Joe Ritchie - *Goldman Sachs - Analyst*

I was just going to say, I was just looking at your trends in the most recent quarters and they've been flat to down, depending on which subsegment we look at. And it looks like you are continuing to lose share in certain pieces of your business. So I'm just curious whether this allows you to potentially stem some of that.

Bob Livingston - *Dover Corporation - President and CEO*

This is a question specific to Hillphoenix?

Joe Ritchie - *Goldman Sachs - Analyst*

Correct.

Bob Livingston - *Dover Corporation - President and CEO*

I will tell you that aside from the Walmart global bid that we lost a chunk of business and we have not lost share with other customers. We have been gaining share.

Joe Ritchie - *Goldman Sachs - Analyst*

Okay.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Keep in mind, we do have disposition in there that you have to take out when you do year-over-year comparisons.

Joe Ritchie - *Goldman Sachs - Analyst*

Fair enough.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Remember on the walk-in cooler --

Bob Livingston - *Dover Corporation - President and CEO*

The walk-in cooler business was divested in the fourth quarter of last year. And if I remember correctly, --

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Brad Cerepak - *Dover Corporation - SVP and CFO*

$90-ish million of sales.

Bob Livingston - *Dover Corporation - President and CEO*

Yes, I was going to say $85 million to $90 million in sales.

Brad Cerepak - *Dover Corporation - SVP and CFO*

$90 million of sales.

Joe Ritchie - *Goldman Sachs - Analyst*

Got it, but in terms of -- maybe the initial question was when does it get rectified, so maybe some thoughts there?

Bob Livingston - *Dover Corporation - President and CEO*

Again, you're asking a question about the Walmart business?

Joe Ritchie - *Goldman Sachs - Analyst*

I'm talking more about the production inefficiencies that contributed to the margin issues.

Bob Livingston - *Dover Corporation - President and CEO*

Oh, the production inefficiencies. I think you'll see us having the two key areas that I've mentioned here around the integrity of the com bond releases and the integrity of holding the production schedule. I think you'll have -- you'll see us have that completed here in the next three to four months.

Joe Ritchie - *Goldman Sachs - Analyst*

Got it, and then maybe coming off of refrigeration and food equipment for a second and talking about fluids. If I take a look at the organic orders over the last few quarters, they have continued to deteriorate. At what stage do you think that this reverses, clearly Wayne closes -- will help you from a growth perspective. But I'm just curious how you're feeling about 2017 from an organic standpoint where we stand this year?

Bob Livingston - *Dover Corporation - President and CEO*

Look, the biggest year-over-year decline within fluids that we've experienced has been the applications and the businesses that are either in the upstream or the midstream oil and gas markets. When I shared that comment, I'm including what we would label internally as our transportation activity around railcar, tank cars, as well as terminal loading arms.

The bulk of that decline has been in North America. That decline has been fairly significant. I think year over year, if I rolled all of that together, it's probably down about 23%, 25%, and it's about, this oil and gas exposure, it is about 22%, 23% of the segment when I include transportation.

We're not expecting any recovery in the fourth quarter, that I can tell you. I think the outlook for 2017 in this part of the business is going to be dependent upon further recoveries in the upstream oil and gas market, and I think we'll have a better feel for that as we move through the fourth quarter.

Joe Ritchie - *Goldman Sachs - Analyst*

Got you. I will get back in queue. Thank you.

Bob Livingston - *Dover Corporation - President and CEO*

We will provide our outlook in some detail in this part of the business at our investor dinner in December.

Joe Ritchie - *Goldman Sachs - Analyst*

Okay. Good enough. Thank you.

Operator

Your next question comes from Andrew Kaplowitz of Citigroup.

Andrew Kaplowitz - *Citigroup - Analyst*

Good morning, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Andrew.

Andrew Kaplowitz - *Citigroup - Analyst*

Maybe just a little more color on fluids in terms of the fluid transfer business. I think Joe asked about it. It did weaken this quarter versus last quarter a little bit more in that particular business. You guys have mentioned big integrated is not spending; in the past, you've mentioned Canadian OPW's weakness, and then of course, Tokheim, you're expecting some improvement in the second half of the year. It doesn't seem like it's materialized as much as you thought. Maybe you could talk about the pieces of fluid transfer.

Bob Livingston - *Dover Corporation - President and CEO*

Okay. Across the board within fluid transfer -- no, actually, I don't want to say across the board, because in a couple of our businesses that deal with the hygienic pharma markets, their order activity and business activity is up actually quite strong. I think 8 or -- it's high single digits, 8% or 9%.

The bulk of the headwinds that we have experienced this year, and again, I'm repeating myself from Joe's question, have been in the upstream and midstream oil-related markets. The North America retail fueling market, and this is not Tokheim, this is now OPW. We've had growth in North America, but it's been less than we expected, and I think third-quarter growth year over year for North America retail fueling, this is the OPW legacy business, I think was 6%.

That said, North -- no, Canada was significantly lower than we expected, and it ended up being a decline in spending with customers or from customers in Canada. Tokheim, I think we're probably going to end the year, the second half will come in fairly close to our expectations of Tokheim that we had in July, but we do see some changes.

Middle East is softer than we were looking at three months ago. China has degraded a bit, but not much; I'm talking 1 million or 2 million, but it hasn't changed that much since the July call. And absent my comment, or excluding my comment on the Middle East, European activity has had growth with Tokheim in the second half.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes, maybe interject.

Bob Livingston - *Dover Corporation - President and CEO*

You want to add anything?

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes, I would interject on there. I think from our last views on Tokheim, we probably see a softer sales number now for the year of about $10 million, $10 million to $15 million, and it's impacting us about $0.02 in the acquisition line. But as Bob said, it's really more the emerging markets part of Tokheim.

Bob Livingston - *Dover Corporation - President and CEO*

For sure.

Andrew Kaplowitz - *Citigroup - Analyst*

That's helpful. Brad, maybe just on 2017, I'm not asking for guidance, but if you look at non-organic pieces, just put and takes, you've got lower restructuring spend from 2017, incremental restructuring savings, your auto after-market acquisition, Wayne potentially coming in, Tokheim more accretive. Given the deal, cost going down. There's just a lot of moving pieces. Are there any advice you could give us on how to model the pieces? And then it looks like compensation investment came down significantly this year. Is it a headwind next year?

Brad Cerepak - *Dover Corporation - SVP and CFO*

We will have a lot to say about it.

Bob Livingston - *Dover Corporation - President and CEO*

I'm glad to get the question, because I told Brad we're not going to give guidance today.

Brad Cerepak - *Dover Corporation - SVP and CFO*

We'll have a lot to say in December, but you're right. I would echo some of the things you're saying; we do see a lower restructuring spend next year. We expect 40 to 44 this year. We always have restructuring, so not giving guidance today, but it's always been put aside tough markets, $15 million to $20 million.

Bob Livingston - *Dover Corporation - President and CEO*

$15 million to $20 million, yes.

Brad Cerepak - *Dover Corporation - SVP and CFO*

So that will be lower. We have carryover benefits on restructuring, which will take us into 2017. My rough number would say that's about $30 million. I think we've said that before. We still see that as an opportunity.

You're right, the acquisitions will be better for us next year. We do have Wayne slipping out now, best estimate is first quarter. We were hopeful to get that done this year, and get some of the final expenses. And not only the final expenses, but I would say the early amortization step-ups through the P&L in the first part of fourth quarter here. That will now hit us in 2017, and I think there will be a lot more to talk about in terms of the integration and the synergy benefits there as we get into December. But too early to really pinpoint a number. We have to first close the deal.

Andrew Kaplowitz - *Citigroup - Analyst*

Okay, guys. Thank you.

Operator

Your next question comes from Andrew Obin of Bank of America Merrill Lynch.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Hi, yes. Good morning.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Andrew.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Just a question on fourth quarter. Seasonally, Q4 is usually below Q3, and I appreciate that there was some idiosyncratic things in Q3, but we are modeling Q4 in line with Q3. And I was just wondering if you could give us big buckets as to what the sequential positives are.

And specific, I also want to understand, you highlighted lower compensation and investment versus your prior guidance. How much of that is in the fourth quarter versus the third quarter?

Brad Cerepak - *Dover Corporation - SVP and CFO*

Well, I will take the last one first and then Bob can talk sequentially; but probably the segment would be best. That compensation, when you think about that investment in comp line, I would say half of it is comp, half of it is just holding back on some adds that we would have normally have done this time of year going into next year.

And I would say it's 50-50 split between the third and fourth. We true-up comp accruals every quarter. And so we're at year to date, updated that through the third quarter, and you'll see a little bit of that coming through in the fourth on that comp line. As far as --

Bob Livingston - *Dover Corporation - President and CEO*

Okay. With respect to sequential trends third to fourth, we expect energy to be up a bit on the top line, more than that improvement on the bottom line. We expect fluids to continue to have growth sequentially into the fourth quarter, and I would --

Brad Cerepak - *Dover Corporation - SVP and CFO*

4% in the third.

Bob Livingston - *Dover Corporation - President and CEO*

Yes, and I would tell you that the bulk of, not all of it, but a significant chunk of it, maybe 60% of the growth we're seeing in fluids from the third to the fourth is retail fueling.

Brad Cerepak - *Dover Corporation - SVP and CFO*

We have growth in mod pump two.

Bob Livingston - *Dover Corporation - President and CEO*

In mod pump. DES will be up, but I would say that's probably all related to the acquisition. I think organically, DES is probably flat. We will see continued growth in our product ID platform, and maybe a very modest decline organically in our industrial platform. And refrigeration segment is down, but it's -- it always is. It's seasonal.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Seasonal, yes, seasonally down.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Just a follow-up question, you made comments on broad industrial weakness, and I appreciate you giving some color. At the same time, if you look at the product ID, those short cycle, more consumer-driven businesses seem to be doing well. Just from a 40,000 foot view, what's happening in the economy, because it seems a lot of other industrials have had weak second half of September?

Bob Livingston - *Dover Corporation - President and CEO*

Yes, you pull out a good example here with our product ID business, especially [Mark Lamage]. And number one, I think we've commented on this a couple of times earlier this year with respect to both China, what we've seen in China over the last couple of years, and in Europe. And I think we're seeing it here in the states here over the last six months or so. A clear difference in spending, in customer spending of what I call OpEx items versus CapEx items. I label our marking and coating business as an OpEx item.

It is interesting when you look at our order trends during the third quarter, what did give me some pause as we closed the quarter was September order rates were actually less than August. That is a bit unusual for us. We have really peeled that to try to understand what's going on and where we're seeing it, but and again, I'm going to repeat it. September order rates were less than August.

That's giving us a little bit of I call it pause for maybe, I hope what proves to be a bit of a cautious approach with respect to our fourth-quarter guidance. If I were to share with you some early reads here in October, October order trends are actually a little bit better than we expected.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Thank you very much.

Bob Livingston - *Dover Corporation - President and CEO*

And that's across the board. I will tell you something else we started to see here in the second quarter -- or in the third quarter, not only with orders that were in our backlogs, but with new orders. We can pretty easily circle about $50 million of revenue that was expected to shift either in the third quarter or the fourth quarter where customers have pushed it out to 2017. It's not anything significant with any individual business, but collectively, the numbers surprised me.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Thank you very much.

Operator

Your next question comes from Steve Tusa of JPMorgan.

Steve Tusa - *JPMorgan - Analyst*

Hey, guys. Good morning.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Steve.

Steve Tusa - *JPMorgan - Analyst*

Just wanted to make sure I got the fluid. You said up -- revenues up 4% sequentially in 4Q, and so is ultimately, and I'm sure what base you were talking about with Tokheim, but what's the actual revenue number you're thinking about with Tokheim this year?

Bob Livingston - *Dover Corporation - President and CEO*

I don't have that with me, Brad.

Steve Tusa - *JPMorgan - Analyst*

Well, you said you tweaked it by $10 million to $15 million, so it's a specific comment, that's all.

Bob Livingston - *Dover Corporation - President and CEO*

Yes, but you asked me for a total number and I don't have that here with me right now.

Steve Tusa - *JPMorgan - Analyst*

It's going to be, Steve, I don't know, around $230 million to $240 million. Okay.

Bob Livingston - *Dover Corporation - President and CEO*

It is down significantly due to the emerging markets, mainly China as we talked about before. Sequentially, Tokheim had, second quarter into third quarter a 13% growth rate. This is the seasonality of that business, and we see that continuing into the fourth quarter with about a 10% sequential ([bee] on Tokheim specifically, 4% for the segment, and that's on the strength of some tenders we one. We'll see them ship in the fourth quarter into 2017, by the way. So 2017 in Tokheim I think will have better comps and better opportunity for us.

Steve Tusa - *JPMorgan - Analyst*

Okay, and then just a quick follow-up. That's great color, by the way, on the fourth quarter. On refrigeration and food, your margins have -- they trended down this quarter. They were down, even adding back the production and efficiencies. Will you be able to grow margins at this business in the fourth quarter? And also has Kroger gotten to you guys as far as giving you any indication of what they're going to spend in 2017 or does that come later in the year?

Bob Livingston - *Dover Corporation - President and CEO*

Well, we have an indication, but we don't get enough, I call it specifics, until a little bit later in the year. And, help me with the number here. We did see within the Hillphoenix backlog, I think about $1 million worth of orders. It may have been less, but there was something. It wasn't a big number, but we did see it.

Steve Tusa - *JPMorgan - Analyst*

How big is Kroger now for you guys? Are they almost as big as Walmart?

Bob Livingston - *Dover Corporation - President and CEO*

No.

Brad Cerepak - *Dover Corporation - SVP and CFO*

No.

Bob Livingston - *Dover Corporation - President and CEO*

No, no, no.

Steve Tusa - *JPMorgan - Analyst*

Okay.

Bob Livingston - *Dover Corporation - President and CEO*

A third?

Steve Tusa - *JPMorgan - Analyst*

And just 4Q margins for refrigeration directionally, because they were down but they were up in the first quarter. So just curious as to how you played that out as you run through these production inefficiencies?

Bob Livingston - *Dover Corporation - President and CEO*

Fourth quarter margins, a little bit better.

Steve Tusa - *JPMorgan - Analyst*

Year over year?

Bob Livingston - *Dover Corporation - President and CEO*

Yes.

Steve Tusa - *JPMorgan - Analyst*

Okay. Thanks.

Operator

Your next question comes from Jeffrey Sprague of Vertical Research.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Thank you. Good morning, guys.

Bob Livingston - *Dover Corporation - President and CEO*

Hi, Jeff.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

A couple of things. Just on oil -- back to energy specifically, just a couple of pieces of color I'm looking for. First, you commented about long cycle weakness. I'm wondering if that's a comment away from the drilling and production numbers in the bearings and compression. Can you just elaborate on that first?

Bob Livingston - *Dover Corporation - President and CEO*

Well, let me give you perhaps a better definition of what I refer to when I say our early cycle applications, and it really is drilling and artificial lift, Jeff. When I label our early cycle applications. Our later cycle -- longer cycle applications, yes, is bearings and compression, as well as our wench business.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Are you seeing further downward pressure specifically in the gas-driven market?

Bob Livingston - *Dover Corporation - President and CEO*

It hasn't -- this has not deteriorated since the second quarter. Our bearings and compression -- the bearings and compression business in third and fourth quarter, we actually see a very, very modest, in fact, it's so modest, you have to call it flat, flat performance from the third to the fourth in our bearings and compression business, and slightly improved margins.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

And then back to the early cycle stuff on the drilling and production side, what are you seeing now on production, completion specifically. Is there an uptick in completion activity with oil here with a five handle, any real inflection noticeable there?

Bob Livingston - *Dover Corporation - President and CEO*

There was an increase in activity in the third quarter on the completion of wells. Let me give you a data point here, a comp. So if I look at rig count second quarter to third quarter, and my number is going to be the quarterly average from second quarter to third quarter. The rig count was up, I think, 14%.

And in our early cycle applications around drilling and artificial lift combined, the growth in that part of the business was almost identical to the increase in the rig count. It correlated very, very well, Jeff. We would expect that correlation to hold true for October and November, as well.

We are being a bit cautious here in our outlook for energy with respect to the month of December. We have some concerns that we're going to see something similar to last year when customers went really quiet for the last two weeks of December. In fact, many of our customers actually did not take product delivery at all for the final two weeks of the year.

I don't know if we're going to see that same phenomenon again this year, but we do expect a little bit of slowing in activity in December. And it's not connected to rig count, per se, it's just connected to customers spending and, I call it balance sheet management.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

I would have guessed, and correct me if I'm wrong, but what you said there about your up 14 tracking to rig count, up 14, implies no net drawdown on ducks in the quarter and I would thought that --

Bob Livingston - *Dover Corporation - President and CEO*

Oh yes, there was, okay, there was a net drawdown. I don't have a number, but I think it was significant relative to what we've seen over the last three or four quarters. I think the net -- and we haven't seen the final data on that, but I think the net drawdown on ducks in the third quarter could be approaching 1,000 wells.

You have to appreciate that 20, 22 -- better than 20%, I think it may be 22% or 23% of our artificial lift business is outside of North America, and that especially in the Middle East and Latin America in the third quarter, we actually saw, I think, a small single-digit decline year over year in our non-North America business. And our US business and our US artificial lift business, it was a little bit better than the rig count increase.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

And just finally, I'm sorry if I can sneak one in, you gave us in the bridge, the deal cost impact in fluids. But can you give us a sense of what the overall mix effects of all the M&A is in fluids? If you can parse that down to almost a same-store sales basis on the core underlying --

Brad Cerepak - *Dover Corporation - SVP and CFO*

So you want core margins, Jeff?

Bob Livingston - *Dover Corporation - President and CEO*

Do you want core margins?

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Yes.

Bob Livingston - *Dover Corporation - President and CEO*

Let's see. We had a -- core margins --

Brad Cerepak - *Dover Corporation - SVP and CFO*

Ex-acquisitions.

Bob Livingston - *Dover Corporation - President and CEO*

Ex-acquisitions and deals cost, 20%.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Thank you very much.

Operator

Your next question comes from Nigel Coe of Morgan Stanley.

Nigel Coe - *Morgan Stanley - Analyst*

Thanks. Good morning, gents.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Nigel.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Good morning.

Nigel Coe - *Morgan Stanley - Analyst*

We covered a lot of ground, so a couple of cleanups from me. Just going back to Andrew's question about the -- a 30,000 foot macro view, what do you hear from customers here? Are we seeing budgets deferred or budget cuts, or is there some softening in the distribution channels where we've seen some imagery headwinds? Any color there would be very helpful.

Bob Livingston - *Dover Corporation - President and CEO*

I think it's somewhat dependent upon the sector. I think the -- what we continue to see in our longer cycle oil and gas applications is continuing budget cuts. And I'm not so sure that the customers are actually cutting their CapEx budgets but that are being reallocated. We are convinced that's happening a little bit here in North America with respect to the E&B rollout.

Even though we, in our OPW legacy business, have shown organic growth year to date and will show it for the year, it is less than expected. And we are rather certain that part of that reduction is being diverted to the E&B rollout. So they're not necessarily cutting their budgets, but reallocating where some of the CapEx spending is going.

In the industrial, that one's a tougher one to call, Nigel. I -- the orders do seem to be closing a bit longer, because the cycle was a bit longer, and as I mentioned earlier, the push outs that we've seen over the last couple of months, I made a comment to Brad here just recently, we'd go back several years before we would find a quarter where we saw that level of push-out activity.

Nigel Coe - *Morgan Stanley - Analyst*

Yes, that's the gist of my question. I'm just trying to figure out what caused that to happen this quarter as to opposed to maybe first half of the year. Okay.

Bob Livingston - *Dover Corporation - President and CEO*

I'm not sure I can answer the question. I can tell you that it's rather evident right now.

Nigel Coe - *Morgan Stanley - Analyst*

Okay. Great. And then just on the fluids margins, in previous quarters you called out the impact of acquisitions. There's obviously a lot of noise in that number. So I'm just wondering if you can give us --

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Bob Livingston - *Dover Corporation - President and CEO*

Let me maybe correct that. When we say ex-acquisitions and deal costs, maybe that number is also ex-restructuring.

Brad Cerepak - *Dover Corporation - SVP and CFO*

It is. It is all out.

Bob Livingston - *Dover Corporation - President and CEO*

Yes, it's all out. It's ex-restructuring, acquisition, and deal costs.

Brad Cerepak - *Dover Corporation - SVP and CFO*

So it really it is the core margin of the continuing business of fluids.

Nigel Coe - *Morgan Stanley - Analyst*

I'm sorry, what was that core margin again, Brad?

Brad Cerepak - *Dover Corporation - SVP and CFO*

20%.

Nigel Coe - *Morgan Stanley - Analyst*

20%, okay, that's helpful.

Bob Livingston - *Dover Corporation - President and CEO*

In the quarter.

Nigel Coe - *Morgan Stanley - Analyst*

Right. And then just a quick one on NG, the comments in your prepared remarks seems to point to the minus 26% or thereabouts on your full-year guide. But then you come to about the December caution, so the reason for the range on energy, the wide range on energy would be because of that December caution, perhaps?

Brad Cerepak - *Dover Corporation - SVP and CFO*

Yes.

Nigel Coe - *Morgan Stanley - Analyst*

Great. Thanks, guys.

Operator

Your next question comes from Deane Dray of RBC.

Deane Dray - *RBC Capital Markets - Analyst*

Thank you. Good morning, everyone.

Bob Livingston - *Dover Corporation - President and CEO*

Good morning, Deane.

Deane Dray - *RBC Capital Markets - Analyst*

One of the changes people that are talking about in retail refrigeration is the recent announcement that Amazon is planning to move into grocery stores. What might the prospects be for Hillphoenix to penetrate this new customer, hat the timing might be, and are you in discussions with them?

Bob Livingston - *Dover Corporation - President and CEO*

No, Amazon is a customer of Hillphoenix. We are working with them pretty closely on their distribution centers, and I know the guys are having discussions on their, I call them their neighborhood rollout program.

Deane Dray - *RBC Capital Markets - Analyst*

Any chance you could size for us what an opportunity that might be and the timing?

Bob Livingston - *Dover Corporation - President and CEO*

They can't even size it for us. From a timing perspective, I doubt you would see anything measurable in our business before the second half of next year.

Deane Dray - *RBC Capital Markets - Analyst*

Okay.

Bob Livingston - *Dover Corporation - President and CEO*

That's a guess right now based upon what little bit we know or that's been shared with us.

Deane Dray - *RBC Capital Markets - Analyst*

Got it, and then on potential divestitures, are you still contemplating others like you did with Tipper Tie? What might the prospects be for those and timing there?

Bob Livingston - *Dover Corporation - President and CEO*

I will turn this over to the guy who runs M&A.

Brad Cerepak - *Dover Corporation - SVP and CFO*

Thanks, Bob. I don't want to say too much about timing on other things, but as you know, we've always communicated that there are parts of the portfolio that, given the right opportunity, perhaps we would look to do something with. That's the best I can tell you at this point.

Deane Dray - *RBC Capital Markets - Analyst*

That's pretty vague, Brad.

Brad Cerepak - *Dover Corporation - SVP and CFO*

I know. I'm not announcing any divestitures today.

Bob Livingston - *Dover Corporation - President and CEO*

Deane, that's intentional.

Brad Cerepak - *Dover Corporation - SVP and CFO*

I'm not about to announce any divestitures today.

Deane Dray - *RBC Capital Markets - Analyst*

Got it. Thank you.

Operator

We have time for one more question. Your final question comes from Julian Mitchell of Credit Suisse.

Julian Mitchell - *Credit Suisse - Analyst*

Thanks for saving the best till last.

Bob Livingston - *Dover Corporation - President and CEO*

We did, Julian.

Julian Mitchell - *Credit Suisse - Analyst*

Glad to hear it. Just on the refrigeration again, really on the top line, and there doesn't seem to have been much linkage so far between the year-on-year change in organic orders and the year-on-year change in organic sales. Orders have been trending pretty good, I think, organically up about 5%.

Bob Livingston - *Dover Corporation - President and CEO*

Orders have been strong, yes. Orders have been strong.

Julian Mitchell - *Credit Suisse - Analyst*

So when do we -- when should that gap start to close? It sounds like Q4 again will be tough for the revenue line. Is it all coming in the first half of next year or the visibility is low on that?

Bob Livingston - *Dover Corporation - President and CEO*

I would say you'll see that get closed maybe not all in the first quarter, but it will close in the first four months.

Julian Mitchell - *Credit Suisse - Analyst*

Understood. And then just within the energy business, the pricing pressure has been stable at around 1.8% the last couple of quarters.

Bob Livingston - *Dover Corporation - President and CEO*

(inaudible)

Julian Mitchell - *Credit Suisse - Analyst*

As your comment -- that's the good rate for next year. Okay. And that should be a good rate for next year. Is that what you meant by no further degradation earlier on?

Bob Livingston - *Dover Corporation - President and CEO*

It should not be any worse than that.

Julian Mitchell - *Credit Suisse - Analyst*

Understood. Thank you very much.

Operator

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

Paul Goldberg - *Dover Corporation - VP of IR*

Thank you, Paula. This concludes our conference call. With that, we want to thank you once again for your continued interest in Dover and we will look forward to speaking with you again next quarter. And just a reminder, our investor day will be in early December and we will send out invitations for that. Have a good day.

Operator

Thank you. That concludes today's third-quarter 2016 Dover earnings conference call. You may now disconnect your lines at this time and have a wonderful day.
