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DOV.N - Q3 2022 Dover Corp Earnings Call

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OVERVIEW:

Co. reported 3Q22 YoverY organic revenue growth of 9%.

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PRESENTATION

Operator

Good morning and welcome to Dover's Third Quarter 2022 Earnings Conference Call. Speaking today are Richard J. Tobin, President and Chief Executive Officer; Brad Cerepak, Senior Vice President and Chief Financial Officer; and Jack Dickens, Sr., Director of Investor Relations. (Operator Instructions)

As a reminder, ladies and gentlemen, this conference call is being recorded, and your participation implies consent to our recording of this call. If you do not agree with these terms, please disconnect at this time. Thank you.

I would now like to turn the call over to Mr. Jack Dickens. Please go ahead, sir.

Jack Dickens

Thank you, Gretchen. Good morning, everyone, and thank you for joining our call. An audio version of this call will be available on our website through November 10, and a replay link of the webcast will be archived for 3 months.

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

With that, I will turn the call over to Rich.

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

All right. Thanks, Jack. Good morning, everyone. Let's start with the performance highlights on Slide 3. Dover delivered revenue growth and margin improvement in the third quarter, driven by rigorous execution and improving price/cost dynamics that were offset -- that more than offset the impact of supply chain challenges, inflationary cost pressures and foreign currency translation.

Demand remains constructive across most of the portfolio with 4 out of 5 segments posting organic growth in the quarter. Backlog at $3.2 billion was up 12% year-over-year and remains approximately double the historical levels relative to revenue, driven by continued strong demand across many end markets.

The supply chain challenges that we've endured over the past 18 months continued to improve, which has allowed us to reduce our backlog this quarter through increased production performance. It is our expectation that this trend will continue for the balance of the year as supply chains and lead times normalize.

Despite the building macroeconomic uncertainty, we are deploying capital to drive productivity and expand capacity in several businesses that are expected to deliver robust growth on secular tailwinds. We closed on the Malema Engineering acquisition in July, which adds a great technology to our biopharma portfolio, and we are continuing to pursue attractive bolt-on acquisitions. During the quarter, we also announced an accelerated share repurchase program to return $500 million of excess capital to shareholders while preserving sufficient liquidity for value-creating investments.

While current demand conditions are solid, our management posture reflects growing caution with the macroeconomic outlook. As such, in the balance of the year, we'll be proactively reducing output in several businesses to draw down inventory balances and initiating cost-containment measures where appropriate.

Our business model is flexible as our 2020 performance has proven. We firmly believe that ongoing improvements in the supply chain and available production capacity will allow us to match production to meet demand within prevailing lead times in Q1 of 2023.

We are adjusting our full year guidance to reflect the negative translation impact of foreign exchange on our revenue and earnings. The estimated full year impact of foreign exchange to EPS is approximately $0.37 per share with notable acceleration during the third quarter as the dollar rallied against most of our trading currencies.

Let's skip Slide 4 and move on to Slide 5. All in all, the quarter developed as we expected. The capital goods portions of the portfolio delivered strong top line and margin expansion on the back of strong order books, lower input costs cycling through inventory as well as pricing actions taking hold.

Engineered Products revenue was up 18% organically in the quarter on broad-based strength across the portfolio in major geographies as well as pricing actions. Margins were up 250 basis points year-over-year as our capital investments and productivity begin to show results and our investments in e-commerce platforms drive aftermarket volume. We expect margins to continue their upward trajectory through the balance of the year on solid volumes and improving price/cost dynamics.

Clean Energy & Fueling was roughly flat on an organic basis. Revenue performance was up in clean energy components, vehicle wash, fuel transport and below-ground retail fueling, but was offset by lower shipments and order trends in above-ground retail fueling, driven by customer construction delays in North America as well as overall caution among operators in Europe and Asia as a result of the weakening macro environment.

Margins in the quarter were flat year-over-year as our clean energy margin mix and decisive cost actions were able to offset the reduced volumes and fixed cost absorption in the above-ground dispenser business. During the quarter, we began to take fixed cost-reduction actions in our dispenser business that were in part enabled by the global product platform harmonization and complexity reduction work that we've completed in the past 12 months, which enabled us to reduce our European dispenser SKUs offering by over 50%. These actions will continue through the first half of '23 and will result in meaningfully improved operating margins going forward.

In Imaging & Identification, volumes for our marking and coding printers and spare parts recovered well on improving electronics input availability as well as the roll-off of COVID lockdowns in China from the prior quarter. Pricing actions and consumables and service demand were positive contributors in the quarter. FX is a negative headwind to absolute revenue and profits in this segment given its large base of non-U.S. dollar revenue.

Q3 margins in Imaging & ID were very strong, improving 230 basis points, driven by pricing actions, product mix richness and improved operational efficiency. Pumps & Process Solutions posted 2% organic growth. We saw solid performance in industrial pumps, medical and thermal connectors, polymer processing and recycling and precision components. As expected, the biopharma components business, which delivered peak revenue in Q3 last year on COVID vaccine demand, declined year-over-year in the quarter as the biopharma industry continues to pivot from COVID vaccines to a growing suite of biologic therapies.

Our nonbiomedical and thermal connector business has grown 30% year-to-date, driven largely by demand in data center and electrical vehicle charger cooling applications. On the back of this demand and forecasted demand, we are finalizing the commissioning of a new assembly plant in the Minneapolis area in Q4.

Operating margin in the quarter remained robust at approximately 30% despite a larger proportion of revenues from industrial products and from improved volumes, pricing and efficiency programs across the segment. Top line in Climate & Sustainable Technologies continued to be strong, posting 19% organic growth on solid volume and pricing actions across all businesses and geographies. All 3 businesses have significant backlogs into 2023. Our capacity expansion programs in CO2 systems and heat exchangers remain on schedule as we continue to invest behind areas of secular growth beyond 2022.

Margins were up 500 basis points in the quarter on price and strong volumes, materially improved productivity in food retail as a result of capital deployment projects and product complexity reduction and improved portfolio mix in can-making equipment and spares and heat exchangers.

I'll pass it to Brad here.

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

Thanks, Rich. Good morning, everyone. Let's go to Slide 6. The top bridge shows our organic revenue growth of 9%, driven by increases in 4 of our 5 segments. FX was substantial at 5% or a $97 million headwind to our revenue growth as well as our profitability, resulting in $0.11 of negative EPS impact in the quarter.

Changes in foreign currency translation from our last guide in July until today are estimated to have an incremental impact of approximately $0.10 to our full year EPS. M&A contributed $55 million to the top line in the quarter, a product of $89 million from acquisitions, partially offset by $34 million from a divestiture late last year.

We saw solid organic growth across our major geographies. The U.S., our largest market, was up 11% organically in the quarter. Europe was up 9% and all of Asia was up 13%. China, which represents approximately half of our business in Asia, posted 8% organic growth this quarter, up from a 4% decline last quarter as our businesses recovered from COVID-driven lockdowns that impacted our ability to produce and sell in the country.

On the bottom of the chart, bookings were down year-over-year due to foreign currency translation and improved lead times across several businesses. Our cash flow statement is on Slide 7. Free cash flow through the first 3 quarters of the year sits at approximately $300 million, down year-over-year on capital expenditures investment, timing of tax payments and performance payments, but mostly on planned investments in working capital.

We have been carrying elevated raw materials and components inventory levels throughout the year, reflective of our high backlog levels and input shortages as well as higher receivable balances on growing sales. We are actively working to bring down our inventory through the balance of the year and expect to further liquidate our working capital position with the degree of cash generation also dependent on the timing of collection of receivables.

We expect free cash flow generation to significantly improve in the fourth quarter, which is historically our highest cash flow quarter of the year. However, the exact timing of working capital liquidation may take into early 2023.

With that, I'm going to turn it back to Rich.

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

Okay. Thanks, Brad. Let's move to Slide 8. Let's discuss the battleground items for the balance of '22 with a brand-new slide, demand trends and backlog. More than a year ago, we were clear that we expected comparable booking metrics to moderate when supply chains start normalizing, and that's the story of the quarter. Bookings were down on a year-to-year basis against a very high comparable quarter, and backlog declined this quarter as a result of improved production performance, which drove the top line.

I call your attention to the middle column of the slide. Our backlog remains at historically high levels, about double where it was relative to sales prior to the pandemic. This is driven to a lesser extent now by extended lead times and customer placing post-pandemic orders much further in advance than normal as a result of supply chain and industrial capacity constraints, but more importantly, by strength of fundamental demand of our products and solutions in multiple markets that are indicated with green arrows on the slide.

We've talked about secular growth drivers in some of these markets previously and we continue to see robust near-term trends driving investment in these businesses. Despite strong demand, shipments were held back in the quarter in several businesses, most notably in Engineered Products, due to hydraulic component shortages and chassis availability and in Climate & Sustainability due to subcomponents availability and capacity constraints. We are currently expanding capacity in both CO2 systems in the United States and heat exchangers in 4 different geographies to meet projected demand.

The portions highlighted in orange, we expected to some degree, but above-ground fueling weakened in the third quarter as our customers have not been able to overcome short-term construction delays, pushing new builds into 2023. And the biopharma transition from the COVID vaccine production has taken longer than we would expect. We expect both to normalize as we move into 2023 based on inventory drawdowns and reconfirmed CapEx plans.

All in all, our backlog remains elevated, and they will continue to support the top line. Additionally, our backlogs give us confidence and visibility to plan our production efficiently. And as I mentioned earlier, will allow us to manage our working capital by flexing production performance to quarterly demand.

Today, about 70% of our Q4 revenue is already booked, and we have a solid foundation of book business carrying to '23 that you can see on the slide by segment, highlighting the healthy mix of short- and long-cycle elements of the portfolio.

Let's go to the bridge on Slide 9. Here shows sources of value creation that lead us to our forecast double-digit EPS growth this year. We expect to significantly offset much of the $0.37 of FX headwind this year through strong execution and cost controls. We are conducting short-term cost-containment measures where appropriate, but more importantly, we are beginning some fundamental cost actions in our Clean Energy & Fueling segment.

The 2023 full year EPS accretion from these actions is expected to -- expected at approximately $0.23 per share. We have additional cost actions underway, which we'll update on the Q4 call.

Between our current inflight restructuring activities and the share repurchases completed this year, we expect a solid foundation of EPS carryover benefit into 2023. As we prepare for various macroeconomic scenarios next year, we are confident in our portfolio's ability to outgrow and out-execute in our respective markets. The niche markets that we participate in are attractive and structurally sound from a competitive point of view.

Our investments in back-office consolidation, e-commerce platforms and product line complexity reductions are providing us a multiyear runway to further reduce our fixed cost structure and variable costs while enriching the customer experience. Through organic and inorganic growth, we have rescaled Dover since the spin in 2018, which provides us increased optionality for the portfolio decisions as we continue our value-creation journey.

In closing, I'd like to recognize that we've been pushing our group hard this year, and I want to thank my colleagues around the globe for their continued dedication and strong performance in a demanding operating environment.

And with that, Jack, we'll go to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Steve Tusa, JPMorgan.

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

So you took down the total revenue by 1%. I don't know, that's like maybe $0.10 or something like that of headwind, depending on how you convert it. You have some buyback benefit here that's pretty close to that. So what's the other part of the reduction in earnings? Is there anything else that's moving around? Or maybe I'm underestimating the impact of revenue. Maybe you're going to the low end of the range?

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

Well, I mean, I think we're taking a guess at FX for the balance of the year, and we've been wrong all year. So there's some caution related to that. Look, at the end of the day, we're going to build what we have in our backlog. I think that we are making an adjustment to our posture somewhat in terms of production performance.

Look, we've been -- you can see in our working capital balances that we've been running excess inventory all year because we've been kind of chasing this demand curve. We've been -- we've seen notable differences and improvements on the supply chain across most of the portfolio with some few exceptions during the quarter, which allows us to change our posture of you know what, let's turn down the production performance machine in Q4 somewhat. Let's liquidate working capital because, you know what, I'm confident that we can restart it in Q1 and push that production performance into next year.

So we get the benefit of the reduced working capital this year, and we get the benefit of the production performance in 2023. I think it's the prudent thing to do. I'm not going to make any comments on what we think about '23 demand yet. We'll wait for next quarter to do that. But clearly, we have some caution in terms of what's going to develop in the marketplace.

I fundamentally disagree with what the Fed is doing now. They say that they're data driven. But if you look at our results themselves, logistics costs, raw material costs have all come down. So the inflation that we had seen over the past 18 months is coming down. But if they are going to continue -- and they believe that they're data-driven. Well, I don't think that we see now the impact. We see it in housing now, the impact of increase in rates.

So if they're looking for demand destruction, then we have absolutely no other posture than to accommodate that by lowering our inventory balances and moving that production into next year. So I think it's a good news, bad news story. I think we get the working capital and the cash flow this year, which under the trajectory we're on right now, we would have been pushing that working capital liquidation almost exclusively into '23. We can pull some of that into '22.

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

Right. So basically, it's kind of like a bit of an under-absorption in the fourth quarter as you kind of turn that production down?

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

That's correct.

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

Said differently? Okay. And then one last one...

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

Let me tell you what, that's right.

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

What will price/cost end up this year? And if you kind of snap the line on all that, what does it end up looking like so far next year? I'm sure there's some -- pricing was a little bit better than expected this quarter. Maybe there's some carryover of price in the next year as well.

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

Yes. Price/cost, you can see it. We had already had been saying all year that in the capital goods portion of the portfolio, because of the inventory balances roll forward and because of the exposure on raw materials, that we expect the back half. And take a look at the performance on both Engineered Products and the refrigeration unit, I mean, those are largely as a result of the dynamics that we discussed in previous calls.

We don't see any pushback right now in terms of pricing, but I think that that's going to be reflective of demand we go through. And more importantly, that pricing wasn't there in the first half of this year. So if everything holds firm, we get a pretty good credit from a comp perspective going into the first half of '23.

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

Okay. And that's positive price/cost next year you would expect?

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

I expect to have positive price/cost in the first half of next year, assuming that demand is reasonable.

Operator

Our next question comes from Andy Kaplowitz from Citigroup.

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

Rich, could you talk about the cadence of orders you've been seeing? I know you recently talked about some expected weakness in above-ground fueling. You've talked today about biopharma continuing to be a little difficult. But did you see any more signs of slowing in orders towards the end of the quarter here in October? And what are your customers telling you about how they might spend on CapEx going into '23?

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

No. The only place that we've seen it are the areas that we called out specifically in the slide. Other than that, we were not seeing those robust crazy numbers that we were seeing a year ago this time. But I mean, I think quarter-to-quarter, across the portfolio, while we're less than 1, I mean we're at 0.96, it's not like we've seen a dramatic slowdown. But what we're hearing from our customers is 2 things.

Those customers that we're providing products into CapEx are -- by and large, every CapEx project this year that our customers have undertaken have taken too long and have cost too much because of labor availability and total inflation. And so what you see now is as everybody gets more cautious about demand in '23 that there's almost this view of, you know what, we're going to push some of this demand into '23. We're going to finish what we got inflight and then we're going to see where we are. That's the signal we're getting, particularly in the above-ground fueling side.

On the biopharma side, I'd just call your attention to every -- all of our customers' results. I will tell you that we started reducing product into the channel much earlier. And we provide a consumable product. So I wouldn't take a look at some of the systems manufacturers and say, "Well, that's a direct proxy." I think that we are a little bit ahead of the curve in terms of that demand.

And as long as those units run, eventually, over time, they're going to consume our products. So we think of this as a margin tailwind moving into 2023. But overall, Andy, at the end of the day, you can't -- as I said to Steve a moment ago, I disagree of what the Fed is doing at this point. There's enough in the system right now that they're going to get what they want. But if they overcorrect, they're going to get demand destruction.

So -- and all of our customers are now on pins and needles about that right now. So we can only do one thing, is that is to prepare for a scenario as such. And because we have a flexible operating model, I think that we just get on the front foot and do in Q4 and if we have to catch up in Q1, so be it.

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

Rich, that's helpful. And then maybe just focusing on DCST for a second. You mentioned you had good visibility in all 3 of your businesses. Obviously, there's been some concerns around Belvac. Maybe you can talk about that. And what are you seeing in sort of core retail refrigeration? And you mentioned sort of the expansion in heat exchangers. All that seems to be reflecting in -- improving margin there, too. So how do you think about margin going forward in that business?

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

Well, I mean, I think that we finally got to where we said we were going to get to. It only took 5 years, but I think that that's -- I guess we can hang our hat on it...

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

Better late than never.

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

Well, I mean, I think we would have made it if not for the whole COVID disaster. But nonetheless, look, Belvac -- when you look at that backlog chart, a big chunk of that is Belvac, right? So it's sold well through '23. At some point, that business is going to have to pivot to more replacement parts, but we look at it as the installed base has increased exponentially. And the margin profile of spares versus built-out units is actually accretive to margins.

Goal for refrigeration, demand is still there. We'll have a little bit of a slowdown in deliveries in Q4 just because we went into the Christmas season when everybody stops doing construction projects. But our backlog there remains robust. CO2, we think we've got secular demand behind it. That's why we're expanding capacity.

And the heat exchangers, look, I mean, we're expanding capacity in every geographical region. I think we talked about it before. We've been the beneficiary of a significant amount of step-up in volume for a product that goes into heat pumps. And if you look at the major manufacturers, they're all announcing capacity expansions worldwide just because of the technology change. So we feel good about it.

Operator

Our next question comes from Jeff Sprague from Vertical Research.

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

Rich, first, just this comment about portfolio optionality that you closed with, obviously, somewhat of a provocative statement. I know you said it at least one time earlier at a conference. I don't suppose you're going to name names on businesses or anything, but you did throw that out there. So maybe just elaborate on what you want us to think as you kind of lay that on the table and where things might be headed.

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

Yes. It's been a couple of years since we got the portfolio questions. I was missing them, Jeff. So I decided to put segments in to restart it. Look, I mean, I think that when we used to get questions about the portfolio, part of the answer that we gave was that you can't descale to the amount that we did back in '18 and then begin talking about portfolio because you run into a scale problem after a while.

So if you remember, we spun off Apergy, when we had to take some significant cost restructuring to accommodate the fact firm-wide that absorption was going to be an issue. And when we got asked questions again about bigger portfolio moves, part of the answer was, hey, look, there's a lot of value that we can create out of the existing portfolio, which we have, but also to the extent that we can rescale the portfolio, then that opens up an avenue where we don't have to worry so much about that.

So that's where we are. If you go take a look at where we were in terms of total revenue, pre-Apergy spin and where we're going to close now, where we've rebuilt that scale and that makes a variety of scenarios more possible on top of the fact that the portfolio in totality is worth a lot more than it was back in 2018.

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

All right. Interesting. So the -- maybe just thinking about bracing for something tougher, as you said, maybe the Fed is going to take us off the cliff here. So the preparatory cost actions, concentrated right now in Clean Energy & Fueling. Maybe just a little bit of color on how you would further prepare if you think things are going south, other areas of potential restructuring and what leverage you could potentially pull.

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

Sure. The Clean Energy & Fueling one is a bit unique. I mean we did -- we were a little bit surprised in Q3 when the demand went down because all the signals that we were getting from our customers were -- that there was plenty of projects through the balance of the year. So it basically forced us taking actions that we were planning on doing in January and pulling them into Q3.

I mean we've been preparing for a scenario around the retail fueling business to adapt its position kind of in a post-EMV world, for years now, right? I mean we spent a significant amount of money in revitalizing the portfolio. At the same time, we spent a significant amount of management time reducing the SKUs, which allows us in the future to make some broader decisions on footprint and a variety of other things.

So to a certain extent, part of what we did was in reaction to the demand environment, but it was coming nonetheless. I just think that we had to pull it forward by about 3 or 4 months. On the balance of the portfolio, I could only go back to March '20. I don't see that scenario. But I think that we've proven that if we have significant demand destruction then there are a variety of levers that we can pull, which I don't want to pull. But I think that we -- if you go take a look at our performance in 2020 in terms of margin preservation, I think that we did quite well.

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

Great. Maybe just one quick one. The 70% of Q4 in backlog, how does that stack up relative to normal?

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

Well, I mean, look, if our backlog is double than historic, then it's 50% more. But I mean -- but it's all over the map depending on whether it's short cycle or long cycle. If you look at that chart, right, printing and ID has got higher backlog, but it's actually quite low relative to its revenue because that's a consumables business. We don't generally carry any backlog there.

So you're going to see a bifurcation between capital goods with longer lead times and bigger build schedules between shorter lead times. They're all up in aggregate, but there's different dynamics between the 5 of them.

Operator

Our next question comes from Andrew Obin from Bank of America.

Andrew Burris Obin - *BofA Securities, Research Division - MD*

Just a question on backlog. We've been going to a bunch of industry shows, and it seems that some industry participants are adjusting just how they think about backlog structurally. There's a view that going forward, we will probably live with just permanently bigger backlogs just because there's less visibility, longer lead times. At the same time, it seems that the industry also realized that maybe, we've heard from some industry participants, sort of protecting themselves in terms of pricing, right? So maybe there are now cancellation penalties.

Can you just talk as much as you can about, a, how do you think about just this order and backlog process evolving into '23? And given the fact that you do now have to probably live with longer backlog, even if you are reducing it, if you've sort of changed the structure of the backlog terms, conditions, pricing, anything like that, big picture?

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

Well, that's a quite the tour de force. Look, there's nothing wrong with having backlog. Given the choice between having it and not having it, I'd rather have it at the end of the day. There are complexities with the issue of backlog because you're managing pricing of the backlog. And if you recall, we suffered at the beginning of this year where we had a large backlog coming out of '21 and then ran into cost inflation. And then we had this grand debate whether you could reprice your backlog, which is really a competitive stack issue, whether you thought you could get away with it or not and everybody kind of did their thing.

I think that backlogs because of kind of the supply chain risk of shortening the supply chain, which I think we've been the beneficiary of, I think that's going to have a little bit of an impact there. So -- but again, I think it's very difficult to compare company-to-company unless they're pure players because certain businesses are always going to have elevated backlogs in the portfolio.

I mentioned Belvac, but Maag would be the same way within our portfolio, where the build time of these products is 90 days, 120 days. So you've got to get basically the orders in there, before you even buy the subcomponents and the raw materials, you need to have the order in place. As opposed to market in Maag, where we don't get all worked up about backlog because it's just consumer volume and being able to price it correctly and make the deliveries on time.

So there's a lot to unpack there, Andrew. I mean, I think because of the breadth of our portfolio, we touch it all, all the scenarios. I think that the actions that we're taking now is a little bit of caution of -- you can't look at backlog trends and then project that into 2023, right? I think that we're basically saying supply chain is caught up now. The backlog that we have that we need to deliver in the back half of Q1, we can make it in Q1, so let's not make it in Q4. That's really the pivot that we're making right now.

Andrew Burris Obin - *BofA Securities, Research Division - MD*

And just -- I'm sure you're going to love my next question. It's on M&A and with interest rates where they are, high-yield markets are in flux. How have you changed your approach to M&A in terms of cost of capital? And what are you seeing from PE players? Are they restricted? Anybody's willing even to do anything in this market? Just high-level discussion of what the end market -- the M&A market looks like.

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

Yes. Well, as you would know better than most, price discovery right now is difficult, right? Because what revenue and what demand is going to be in '23 is anybody's option. And then you've got this whole issue of, boy, I could have sold this thing 18 months ago and got this crazy multiple, and now I can't have it anymore. So you're basically -- you just look at all the big banks. I mean no one's really doing much.

Fundamentally, we haven't changed our outlook at all. Sure, we'll make some adjustments to our WACC rates and everything else and the discount rate to reflect current interest rates. But we're not buying things with debt at the end of the day. I mean, I think that that's just muddling. So we're still -- we've got some opportunities in the pipeline that hopefully we can close on in the medium term. So we're still on the front foot, but the price discovery is difficult. Let me just put it that way.

Operator

Our next question comes from Joe Ritchie from Goldman Sachs.

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

Rich, maybe just a higher-level question to start. You guys talked about the capacity expansion. Obviously, the backlog is in good levels today. I'm just curious how you're thinking about that in the context of a potential slowdown in 2023, and ultimately, how you potentially manage to maybe having excess capacity if the demand environment does slow.

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

Yes. Well, look, I mean, where we're expanding capacity is where we believe that we've got secular demand, okay? So when we're -- what we're doing up in Minneapolis -- I mean, I think I referenced it. If you go back and look at the transcript about the growth rate that we've seen there, I think the same thing with the heat exchangers.

So I've got high confidence about where we're fundamentally expanding capacity and what we're doing it for. But having said that, at the same time, we've begun again after taking a time out due to COVID and this big demand ramp that we've seen over the last 18 months, where we can start actioning footprint again. So arguably, and I haven't -- I can't tell you on a square foot basis, but I'll bet that we're taking out as much fixed cost footprint in '23 as we're adding.

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

Got it. Okay. That's super helpful. And I guess my follow-on question would be on the pumps and process business. You've been calling out this transition in biopharma pumps now for the last couple of quarters and the fact that you basically just -- you're up against your toughest comp a year ago. I'm just curious, if we -- do you think we've hit a trough in margins in that business? And maybe you can just talk a little bit more about how much longer you'll continue to see that transition across that piece of your portfolio.

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

Yes. Some of the growth that we missed on margins, we were 29.7% versus 30%. God help me. But anyway, look, we think that the segment itself is a 30% full year margin business. You'll get some volatility quarter-by-quarter. We've seen it, right, because of the fact -- but I think that we were trying to say, if you go back and look at what we were saying in Q2, Q3, a year ago of -- let's not get all excited. I think that we posted 35%, 36% margins during that time period that we kept saying that 30% was kind of the new normal for the segment itself.

I got to tell you, I'm actually very pleased with the margin performance in Q3 because what you can't see is the mix impact of how much biopharma is down, which is down a lot, right, because we've just got capacity meaningfully to let this inventory liquidate. But the margin performance we're getting out of what were sub-20% industrial businesses that make up the balance of the portfolio, we've actually lifted those businesses up.

So if this has happened to us 3 years ago, the margin compression that we would have seen would have been meaningful. But the fact of the matter is, is that the operators on the industrial side have improved their margin profile significantly, which has allowed us -- we're going to do 30% for the year. So overall, we look at this at this point, what we'll take -- if we take another quarter of pain on the biopharma side, so be it. I look at that as a potential margin enhancement now for 2023 as opposed to a headwind.

Operator

Our next question comes from Scott Davis from Melius Research.

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

Most of my questions have been answered. But on the FX side, Rich, is it still mostly just a translation issue? And -- or is it -- or have we gotten so extreme now that there's actually some global trade that's being adjusted?

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

Look, the vast majority is translation. I'll let Brad step in because if you can imagine with having 18 operating companies, finding out transaction on FX, I don't believe it's meaningful. But he's done...

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

No. That's correct. It's mostly translation. And as you know, as we talked about in the script, we said the strength of the dollar was so fast in Q3 here that it really changed the dynamics of what we saw and the impacts on top line and on our EPS. And again, it's about $0.10 forecast-to-forecast. Happens to be about $0.10 at the midpoint of our guide, too. So you could look at it that way.

There's lots of ways to look at our guide change. But I would tell you, FX and where we're at now and the strength of the dollar, it's significant. And it's been significant all year, but even more so now. I don't think we're unique, though, Scott. I don't think we're unique in that regard.

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

Likely not. So just to back up a little bit, Rich. On the M&A side, you made some comments, but it's -- how wide is the lens, I guess, is a question I want to ask. Is that -- are you -- I mean there's assets available, we're told at least, by folks. And there's not a counterbid by some of the traditional folks out there. People are hunkering down a bit. But is the lens wide enough where you take a stab at maybe something that is a little bit afield of your existing portfolio?

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

No. And I guess the question is how long is a piece of string? I mean, I think -- I'll answer your question in 2 ways. I think it's got to be a business that we believe that we've got a fundamental right to run, right? We're a manufacturer at the end of the day. So it's a manufacturing business and the processes on the factory floor are similar to what we do, meaning that we've got a management team that knows how to extract value out of it. It doesn't necessarily have to be in an end market that we participate today.

But we are not making any left or right turns into whatever the new area for industrials to go in and chasing thematics. I mean we're much more blockers than tacklers. We know what we're good at. And we know that we've built a back-office engine now that allows us to extract meaningful synergy costs out of like-minded businesses over time and that kind of -- that's our knitting. But back to the issue about the scale, we've got the ability now to take on something materially larger than we would have undertaken back in '18 or '19.

Operator

Our next question comes from Joe O'Dea from Wells Fargo.

Joseph John O'Dea - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

I wanted to revisit base cost and then the cost side of things. And could you talk about the raws piece versus the components piece and timing of when we start to see some of that come in? I would assume that raw just kind of flows through, but I'm not sure what you're seeing from your suppliers and how much pressure you're putting on them to get cost down in a lower raws environment.

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

The raws -- as we talk about raws because we're a purchaser of raw material, you're seeing the benefit now, right? There was a issue of getting hung up in inventory back in Q2. Now you see the roll-forward in Q3 plus the fact that we priced for it, and we're positive price/cost now on the raw side.

On the subcomponents, it's a little bit over the map. We don't see on the subcomponents the pricing come down yet because currently, demand exceeds supply. If that was to change, then we would be a lot harder on some of our kind of component suppliers to reflect that in their pricing. So right now, everybody is in a standoff between, well, you want the product, so you're going to pay for the product. We'll see.

And we're part of that chain also. So right now, we're getting the benefit of reduced raw material cycling through inventory and the pricing. We're not seeing it on our purchasing of subcomponents yet, but that will be dependent on volume, I guess, as we go forward.

Joseph John O'Dea - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Got it. And then on Clean Energy & Fueling and the cost out, just the magnitude of the margin benefit to make sure -- sort of think about the cadence and impact properly. I mean it looks like this is something like a 250-basis point margin lift, something we could be seeing as early as Q4. Maybe just talk about cadence and magnitude on that. And then to the degree you're willing to kind of touch on some of the additional cost out, how the magnitude of that compares to what you're currently sharing?

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

You won't see it in Q4 other than the fact that it's buffering the negative fixed cost absorption by taking the production down. So what you'll see -- you can't see it, but what you see in the segment margin, and you see it in Q3, that if we're taking some of that cost action, then you would have seen a margin compression in the segment. We expect that to remain for Q4, subject to what we do across the portfolio in terms of production performance.

And so you have the rollover benefit in the bridge there. And Joe, we're going to do at a Investor Day because we haven't set longer-term margin targets. And I think let's wait until we get to guidance for '23 and we do that Investor Day. And I think we'll clarify what the upside is because it's a fundamental change to the business model. It's not just cost takeout.

Operator

Next question comes from Deane Dray from RBC Capital Markets.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

A couple of clarification questions. I want to go back to Andy's questions. And you've got a decline in bookings. It's modest. But Rich, is there any impact as you improve lead times? We're hearing the customers then don't have to order in advance as much. So -- and also fewer units in their orders. Are you seeing that dynamic playing out?

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

Not the fewer units because the lot sizes -- on the components business, the lot sizes are what they are and then the buildup units, we get orders of 1. No -- but look, Deane, I mean, at the end of the day, it's natural. Why? With the uncertainty that's out there, this hope that pricing is going to come down and everybody recognizing the supply chain is better, no one's going to order transactional products 6 months in advance. Which I think that when our backlog was going up, we were warning everybody. But despite the fact everybody wants to write book-to-bills down by 0.5%.

And it's healthy in a way. So what our customers are saying is, "We're going to go back to the more traditional order patterns or not." We have a lot of discussions with our customers about capacity utilization. And it goes back to a discussion as opposed to if you don't give me your orders, you're not getting the product. And that's where we were for the last 18 months.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

Got it. And then just on your European outlook, you're not seeing it in the numbers yet, but are there any contingencies you have in place and maybe even for fuel availability? Just how have you thought that through for the next couple of quarters?

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

We are a small manufacturer from a footprint point of view in Europe. So we have exposure to fuel as an input cost, but it's -- I mean we're not a chemical manufacturer. It's just not the same. But we are cautious about the demand for Europe and have been cautious about the demand in Europe all through the quarter. And so part of this whole discussion about taking down production performance and liquidating working capital, that's -- part of that is a European phenomenon.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

That's helpful. And just last one. Could you just clarify on the pump side and biopharma? How is your mix related to non-COVID? You've had a COVID boost. But if there's less COVID production, vaccine production, et cetera, how is your non-COVID exposure?

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

Yes. I'm not going to break it. I think you can send that as a follow-up, and the guys can work with you in clarification. I don't want to go through because, actually, I don't have it at the top of my head. So let me -- let the guys work that up for you, and they'll take you through it.

Operator

Our next question comes from Nigel Coe from Wolfe Research.

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

So Rich, as we -- you kind of -- obviously, you're talking about some cost reduction selectively across the -- in fueling. You're talking about the Fed. And I think we're sympathetic to your view about demand disruption. But are you taking any other measures, maybe dampen the brakes on hiring? It sounds like CapEx, you're investing in selectively. But what about CapEx? Are you thinking about CapEx down in '23? I mean, any other measures to prepare for a more uncertain macro?

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

Sure. I think the CapEx is going to be down in '23, and it would have been under any demand scenario. I think that what we've got in the pipe -- what we've done and what we've got in the pipe -- we haven't done the full budget for next year, but I think that, off the top of my head, it was going to be down regardless.

So I think it's going to be mostly maintenance capital and inflight that we've already announced frankly. I'm not aware of anything hanging out there. Yes, on the hiring, yes, selectively, selectively by region and then selectively by business. I think that we've been doing that progressively during the quarter, for sure.

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

Okay. And then on the inventory, there was a slight build Q-o-Q. I'm not sure if that was mainly inflation impact. But how much inventory do you think you can get out of the system by year-end? I understand you've talked about 1Q '23 being tough still there. But how much do you think realistically you can get out by year-end? And maybe just -- I don't know, Brad, if you can just address the production penalty that you're expecting for 4Q.

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

Okay. I'll take it. I think that, as Brad mentioned in the -- above, we expect inventory -- we don't have a lot of -- first off, we don't have a ton of finished goods inventory. What we have is WIP and raw materials, right? And that's going to come down.

The issue is going to be, depending on the cadence of the revenue, how much is going to get hung up in receivables. So we've taken production performance down to push hard on inventory because we think that we -- I already discussed why. So I don't know if Brad is going to monetize it for you. it's going to be meaningful. But I think you got to be careful about between the size of the inventory drawdown versus the benefit into working capital because of the receivables.

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

Yes. I think -- and that's exactly what we said was -- it's the timing element to it. What I would say is it's taken a long time to build the inventory. It's going to take some time to take it out, but we're proactive on it. I think fourth quarter is going to look a lot like we've done historically. It is our highest quarter.

If you look back in time, you'll find 6 out of the last 7 years with high teens, in some cases, over 20%, free cash flow to revs in the fourth quarter. Our goal is the combination of taking out inventory and liquidating some of the receivables to mirror that. We'll see how well we do. Like I said in the prepared comments, it could take into the first part of '23.

Operator

And our last question comes from Julian Mitchell from Barclays.

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

Maybe I just wanted to try and circle back on the sort of inventory and cash flow dynamics. So I just wondered if -- when you look at your customers' inventory levels and maybe the excesses there, do they sort of map and match where you think your excess inventories are as well? And maybe just call out some of the areas when you're looking at the customer or distributor that you sell into, where you think there might be the most sort of pernicious excess inventory.

And also when you're thinking about toggling sort of underproduction and the impact on EPS versus your free cash flow, should we assume that next year perhaps we have subpar cash flow conversion as well just as you try and sort of protect the earnings while bringing down inventory and receivables?

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

Well, okay, where to start on that. If we take production down, it's to liquidate inventory, right? So if we go into next year, hopefully, the inventory comes back because that means that demand is robust. So -- but we're not going to talk about '23 demand because nobody knows.

Our inventory that we can see is in distribution and we are not aware of excess inventory in the supply chain. What we can see is OEM inventory. And that's kind of what we saw from when biopharma turned down, that there was a lot of excess inventory on the OEM side.

But we don't make product -- we don't make finished goods product to be called off. So our finished goods inventory that we have is for an order. The only thing that we have is raw materials. So I'm not sitting here being overly concerned that we've got excess raw materials that are not going to get consumed over time. It will get consumed depending on the velocity of the demand.

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

Understood. And my follow-up just around the restructuring and the cost-out. So I think your restructuring expense guide for the year is unchanged at $0.17 now. I think it was $0.16 before, and that's probably just the share count guide coming down. But it seems like you're talking up the cost savings from restructuring next year. So I'm just wondering sort of how you're generating those savings if you're not booking the sort of P&L restructuring or not stepping up the booked P&L restructuring expenses.

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

No. Julian, I'm not talking about the restructuring expenses. What I'm saying is -- in that chart is the benefit. We've given you the EPS benefit of the restructuring within '22 and the full year benefit of those announced restructurings in '23. We have got other restructuring projects that we're working on that we will announce in time.

The fact of the matter is when we take a restructuring charge, we feel obligated to tell you what the benefit is, and that's on a 12-month benefit going forward next year. It does not include any restructuring that has not been announced.

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

I understand. So the savings next year, we could see some of that reflected in -- or the measures for that in restructuring expenses in '23 itself?

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

Yes.

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

Of course. Yes, full year benefit of it, for sure.

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

But some of that is also in '22, as Richard said. So it straddles both.

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

It's not double counted, I guess, is what we're saying.

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

Yes. Yes.

Operator

Thank you. That does conclude our question-and-answer period and Dover's Third Quarter 2022 Earnings Conference Call. You may now disconnect your line at this time and have a wonderful day.
