

# **Flowserve Corporation (FLS) Q2 2024 Earnings Call Transcript**

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**Body**

Flowserve Corporation (FLS)

Q2 2024 Earnings Conference Call

July 30, 2024 10:00 AM ET

Company Participants

Jay Roueche - Vice President, Treasurer and Investor Relations

Scott Rowe - President and Chief Executive Officer

Amy Schwetz - Senior Vice President and Chief Financial Officer

Conference Call Participants

Mike Halloran - Baird

Joe Giordano - TD Cowen

Andy Kaplowitz - Citigroup

Deane Dray - RBC Capital Markets

Damian Karas - UBS

Nathan Jones - Stifel

Brett Linzey - Mizuho

Eric Look - Mizuho

Joe Ritchie - Goldman Sachs

Presentation

Operator

Good day, and welcome to the Second Quarter 2024 Flowserve Corporation Earnings Conference Call. Today's conference is being recorded.

At this time, I'd like to turn the conference over to Jay Roueche, Vice President, Treasurer and Investor Relations. Please go ahead.

Jay Roueche

Thank you, Melinda, and good morning, everyone. We appreciate you joining our conference call today to discuss Flowserve's second quarter 2024 financial results. On the call with me today are Scott Rowe, Flowserve's President and Chief Executive Officer; and Amy Schwetz, Senior Vice President and Chief Financial Officer.

Following our prepared comments, we will open the call for your questions. As a reminder, this event is being webcast and an audio replay will be available. Please note that our earnings materials do, and this call will, include non-GAAP measures and contain forward-looking statements. These statements are based upon forecasts, expectations and other information available to management as of July 30, 2024, and they involve risks and uncertainties, many of which are beyond the company's control. We encourage you to review our safe harbor disclosures as well as the reconciliation of our non-GAAP measures to our reported results, both of which are included in our press release and earnings presentation, and both are accessible on our website in the Investors section.

I would now like to turn the call over to Scott Rowe, Flowserve's President and Chief Executive Officer, for his prepared comments.

Scott Rowe

Thanks, Jay, and good morning, everyone. We delivered another quarter of strong results with sequential and year-over-year improvements driven by outstanding execution. Compared to the second quarter last year, some highlights include: revenue growth over 7% with adjusted gross and operating margins increasing to 32.3% and 12.5%, while our adjusted earnings increased more than 40% per share. Our strong bookings of $1.25 billion in the quarter, represents a 12% increase versus last year and sequential growth of 20%. With a book-to-bill of almost 1.08x in the quarter, our backlog grew over $70 million sequentially to $2.7 billion, positioning the company for further growth. I want to thank our associates around the world for their passion and dedication to supporting our customers in delivering these impressive results.

Continuing with second quarter commentary. Our adjusted earnings per share was $0.73, representing a sequential increase of $0.15 and $0.21 year-over-year. Our bookings are at the highest level since 2014 and included a healthy mix of project awards with ongoing strength in both MRO and aftermarket activity. We generated over $1.15 billion in revenue and increased our adjusted gross and operating margins by 200 basis points and 210 basis points respectively, versus the prior year, which gives us further confidence in our margin progression journey.

We are very pleased with our results and the progress we have made in the last couple of years, as we implement and capitalize on opportunities for growth and further improvement. Our operational excellence program continues to deliver results with significant progress within our manufacturing facilities. The new organizational design, combined with improved process discipline is allowing us to operate at a much higher level. While the recent results are impressive, we are confident that there is further upside as we continue to drive maturity in our operations journey.

Additionally, we launched our formal product excellence program earlier this year. We have undergone an extensive product portfolio review within one of our seven business units and have identified significant opportunities to deliver higher margins without compromising our focus on growth. We plan to launch this program with our second business unit next month and a third business unit before the end of the year. As discussed at our Analyst Day last year, we have committed to an incremental 100 basis points to 200 basis points of margin improvement from the product excellence program by 2027. The early progress is encouraging, and we expect to begin to see results from this effort in the back half of 2024 and 2025.

Operational and product excellence are essential components of the new Flowserve business system that was created to deliver improved process consistency and financial performance across Flowserve.

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Let me now turn to bookings in our end markets. Our second quarter bookings of $1.25 billion marks our tenth consecutive quarter with bookings over $1 billion. Our 3D growth strategy represents over 25% of our total bookings again this quarter, reaffirming our strategic approach. Our bookings were balanced in the second quarter with original equipment and aftermarket activities each representing about half of the total. For original equipment, we benefited from three large projects in the Middle East, including the two we announced in April. Together, these large awards totaled approximately $200 million.

The elevated asset utilization rate and spring turnaround season at our customers' operations led to record quarterly aftermarket bookings of more than $610 million. In addition, we have now delivered seven consecutive quarters above the $550 million level, showing the resilience of this higher margin, faster turn, parts, service and repair work. Flowserve's local presence, strong customer relationships and high levels of service continue to produce solid capture rates on our vast aftermarket entitlement. We expect the world's existing refining, chemical and power facilities will remain at high utilization levels for the foreseeable future and our aftermarket business is well positioned to service their need for continued operability.

By end market, oil and gas generated the highest level of dollar growth, representing a year-over-year increase of about 22% and includes two of our three large projects we received this quarter. We also continue to capture a substantial number of 3D bookings that are recorded in this end market, primarily in decarbonization activities such as carbon capture, biofuel conversion, LNG and our energy advantage program.

We also demonstrated significant growth within the chemicals market this quarter, booking $272 million. This represented 14% growth versus the prior year and was driven by the Emerald greenfield petrochemical project in Saudi Arabia, which was announced in April. We continue to expect significant chemical capacity additions in the Middle East and modest improvement in overall global chemical demand. We are also making good progress with all aspects of the 3D strategy diversifying into specialty chemicals and plastic recycling, decarbonizing existing petrochemical facilities and adding Red Raven to flow control products in both existing and new chemical plants.

Last quarter, I highlighted the expectation for increases in power generation, driven by the growth in data center capacity fueled by ever-increasing artificial intelligence activity. Second quarter power bookings were $153 million, which represents a 34% increase year-over-year. Additionally, nuclear activity saw particular strength this quarter with more than $70 million in bookings. We continue to be optimistic about nuclear power generation growth for new projects in light -- life cycle extensions in various parts of the world.

Another end market we are seeing encouraging signals is the mining industry. As more rare earth minerals and other mine products are needed for batteries, electrical transmission, energy storage and grid hardening, we see stable long-term growth in this sector. Currently, our efforts in mining are included in our general industries bookings and amount to roughly $100 million a year of activity. We plan to increase our organic efforts in mining to capture a larger portion of this expected growth through enhanced channels to market and further new product development. Additionally, as we evaluate inorganic opportunities to create value for our shareholders, further mining exposure would be one area of interest to help fortify our existing offering and achieve our stated goal of diversifying our portfolio of products and services.

Turning now to second quarter bookings by region. We saw strong growth in the Middle East on the back of the three large projects as well as modest growth in the Americas. Europe and Asia-Pacific bookings declined slightly year-over-year. Our overall project funnel is up 8% year-over-year, reflecting the continued visibility into significant project opportunities in the Middle East and other parts of the world. Our traditional short-cycle MRO and aftermarket business has proven quite durable, and we expect to see continued growth on this side of the business.

As a result, we believe the macro environment and outlook remains favorable for the full control space. We continue to see positive signals driven by the key global megatrends from energy transition and decarbonization to energy security and regionalization to electrification and digitization. Combined, these current and potential megatrends are attracting significant investments. Flowserve is well positioned to capitalize on these trends and drive further growth.

In the second quarter, we grew our backlog sequentially by over $70 million to $2.7 billion, positioning us for continued revenue growth. We expect our full year book-to-bill ratio in 2024 will exceed 1.0x and we are off to a good start to the first half of the year with a book-to-bill ratio of 1.02x. Combining our solid performance for the first half of the year with expectations for continued improvement, we have increased our full year adjusted EPS guidance range for the second time this year to $2.60 to $2.75, which at the midpoint represents a nearly 27% increase year-over-year. We are making significant progress at Flowserve, and we believe we are well on our way to achieving the 2027 financial targets that we communicated at last year's investor event.

I will now turn the call over to Amy to address our second quarter results in greater detail. Amy?

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Amy Schwetz

Thanks, Scott, and good morning, everyone. Looking at our financial results in more detail. We generated another quarter of strong sales, nearly $1.2 billion, which combined with improved margins, delivered adjusted earnings per share of $0.73, a 40% increase versus last year. I want to echo Scott in thanking our associates for their continued efforts and execution, which were instrumental in driving both top and bottom line growth during the quarter.

Our support of end markets, robust asset utilization by our customers and focused efforts from our sales team led to record quarterly aftermarket bookings of $614 million. Coupled with strong revenue conversion, our operational excellence led margin improvement initiatives and ongoing cost discipline, we generated adjusted operating margins of 12.5%, which represented year-over-year and sequential improvement of 210 basis points and 160 basis points, respectively.

With $0.18 of net adjusted items, our reported earnings per share was $0.55. The largest adjusted item was realignment expense, and it was primarily related to our divestiture of the NAF AB control valve business, which principally serves the pulp and paper market. The largely non-cash charge from the divestiture was $13 million or over half the total adjusted amount. The NAF business had modest and cyclical annual revenues and was breakeven at best. This transaction is indicative of how we are optimizing the portfolio by proactively taking action with respect to end markets and products dilutive to the overall business and it's just one example of how we intend to drive further margin improvement across our business.

On the strength of our first half results, combined with opportunities we see ahead for the rest of the year, we are narrowing and increasing our full year adjusted earnings guidance range to $2.60 to $2.75 per share. At the new midpoint, this would represent a 27% increase compared to last year's adjusted EPS. To provide context to the phasing of guidance for the balance of the year, we still expect a stronger second half of this year compared to the $1.31 of adjusted EPS we delivered through June 30.

Over the past several quarters, we have highlighted steps taken to smooth the quarterly seasonality of our business. And looking ahead, we do expect less differentiation in 2024 than in past years. As you can calculate from our full year revenue guidance, we do expect our year-over-year growth rates to moderate in the second half as we encounter tougher comps. Additionally, while we typically don't provide quantitative EPS, I will say that the third quarter should look operationally very similar to our solid second quarter performance.

Our third quarter results could be impacted by the annual true-up of certain incurred but not recognized liabilities. We are considering the next-gen purchase announced last week to be akin to M&A, and we will exclude the Q3 related expenses from adjusted EPS. We continue to expect our fourth quarter to be our best performing quarter.

Let me now turn to the second quarter in greater detail. Our 7% year-over-year revenue increase was comprised of FCD's and FPD's growth rates of 9% and 6%, respectively. The increase was also driven by both our original equipment and aftermarket activities, with revenue increases of 9% and 5%, respectively. All regions also contributed to the top line improvement with notable year-over-year percentage improvements in Latin America, the Middle East and Africa and Europe of 13%, 11% and 7%, respectively.

Shifting to margins. We generated adjusted gross margins of 32.3%, representing a 200 basis point increase year-over-year and 60 basis points sequentially. As Scott mentioned, our improvement was largely driven by our operational excellence program, solid execution and top line leverage. We expect this, in combination with our product management efforts will expand margins even further as we progress towards our 2027 target level.

By segment, FPD's adjusted gross margin of 32.9% was a 300 basis point year-over-year improvement. This progress is encouraging, especially considering a nearly 6% increase in generally lower-margin original equipment revenue. FCD also improved their adjusted gross margin to 30.6%, a sequential improvement of 140 basis points. For the first half of the year, FCD's gross margin was impacted by product mix. So we are pleased to see the quarter-over-quarter improvement. We believe FCD's margins will improve substantially in the second half of the year due to improved product mix and more effective demand planning at facilities.

On a reported basis, second quarter consolidated gross margins increased by 170 basis points to 31.6%, despite net adjusted items within cost of sales increasing by $2.6 billion versus prior year. Second quarter SG&A increased $17 million year-over-year to $236 million. Despite this dollar increase, adjusted SG&A as a percent of sales was up modestly 20 basis points to 20.4% driven by solid top line growth during the quarter and our ongoing cost discipline actions.

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On a reported basis, second quarter SG&A increased by about $9 million, primarily due to a lower level of adjusted items. At 20.6% of sales, SG&A actually decreased by 70 points versus the comparable period. Our adjusted operating income in the quarter was $144 million, an increase of nearly $32 million year-over-year. Our robust adjusted operating margin of 12.5% was a 210 basis point expansion and delivered an exceptional incremental margin exceeding 41% year-over-year.

As we indicated earlier in the year, we expect our 2024 performance to be a margin-first story, driven by improvements from our new operating model and discrete actions we're taking, combined with revenue leverage. We expect that as we continue to perform, we will be well positioned to achieve our 2027 adjusted operating margin target of 14% to 16%.

By segment, FPD delivered a very strong adjusted operating margin of 16.9%, representing a 370 basis points and 200 basis points year-over-year and sequential improvement, respectively.

FCD also increased its adjusted operating margin to 13.4%, which was up 230 basis points on a sequential basis. We also expect to see continued adjusted operating margin expansion in FCD during the second half of the year, primarily as a result of higher gross margins from operational efficiencies. On a reported basis, second quarter operating margins increased 160 basis points year-over-year to 10.5%, driven by our operating leverage and higher realized margins, despite the $7 million increase in adjusted items.

Our second quarter adjusted and reported tax rates were approximately 21.3% and 23.8%, respectively. This quarter's reported tax rate was elevated considering the loss on sale of [NASS] and no associated tax benefit. We now expect the full year 2024 adjusted tax rate of around 21% higher than a year ago when we saw the release of discrete valuation allowances in certain jurisdictions.

Turning now to cash flow. After six consecutive quarters of consistent cash generation from operations, the second quarter was an operating cash use of $13 million, driven by working capital requirements, primarily in accounts receivable and accrued liabilities. Our receivables increased as a result of the timing of this quarter's strong revenue performance, which was partially offset by an over $27 million sequential reduction in inventory, including net contract assets. Additionally, as expected and in line with previous practice, we paid our 2023 performance based incentive compensation this quarter impacting the accrued liabilities account.

As a percent of sales, we saw our second quarter adjusted primary working capital become more efficient and decreased by 260 basis points year-over-year, as the 7% top line growth outpaced the 4% increase in our adjusted primary working capital accounts. On a sequential basis, this ratio increased a modest 90 basis points to 29.3%. For the remainder of the year, we expect our cash generation generated from operations to accelerate. As such, we anticipate our free cash flow generation to adjusted net income conversion rate of around 80% or more for the full year.

Other uses of cash during the quarter included $71 million for dividends, capital expenditures and a term loan reduction and share repurchases. Through the first half of the year, we repurchased about 340,000 shares of our common stock for a little over $60 million in addition to returning $55 million in dividends to shareholders. As we execute our capital allocation commitments we announced last fall.

As I referenced earlier, last week, we announced the acquisition of in-process LNG pump technology, which we believe will further accelerate our 3D strategy. This transaction exemplifies our capital allocation approach. Our inorganic pipeline is robust, and we remain interested in targets that will drive long-term returns and enhance our 3D strategy. We will remain disciplined with our capital allocation, and we believe our framework will guide us to direct our investment dollars to the highest return and long-term returns for our shareholders.

In summary, while we are proud of the results we delivered this quarter and through the first half of the year, we continue to see opportunities to expand margins and earnings during the rest of the year. We also remain confident in our progress and ability to achieve our 2027 goals.

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Let me now return the call to Scott.

Scott Rowe

Great. Thank you, Amy. I would now like to provide an update on our R&D activities across the LNG and hydrogen end markets that support our decarbonization growth strategy. In the third quarter of 2022, we acquired Chart Industries in-process hydrogen distribution pumping technology. We were able to commercialize the technology last year, and we are now receiving ongoing orders for the pumps. Our technology enables safe and reliable hydrogen fueling.

In the second quarter, we booked $7.5 million related to the construction of 10 new fueling stations in the United States. We're excited about the opportunity to support the expansion of this green fuel source. Additionally, we believe the technology that we developed for hydrogen fueling can be used in other cryogenic gas applications.

Last week, we announced the purchase of in-process R&D for submerged cryogenic pumps for liquid natural gas from a start-up company called NextGen Cryogenic Solutions. Flowserve has a significant presence in LNG across our pump, valve and mechanical seal portfolio, but we were missing the submerged cryogenic pump offering, which sits at the heart of the liquefaction and regasification processes.

This acquisition from NextGen fills this gap with differentiated technology in a technically difficult space. We expect to fully commercialize our first variation of these pumps in the second half of the year, and we expect to generate bookings in 2025. We remain excited about the growth of LNG and we believe we will capture additional market share with a more comprehensive suite of pump products.

In summary, we have made great progress to enhance our product portfolio through small technology acquisitions that built on our flow control competence and domain expertise. Diversification also remains an important part of the 3D strategy, and we continue to drive growth through enhanced focus, improved channel strategy and new product development. Our diversified bookings grew sequentially again in the second quarter, and we continue to apply our portfolio into end markets that present an above-average growth profile.

During the quarter, we were awarded a contract from a major global chemical company to supply pumps and valves in the construction of a new commercial scale molecular recycling facility in Germany. This facility will convert over 50,000 tons of plastic waste annually into new polymers for use as feedstock into food safety, healthcare and other diverse industries.

Lastly, on digitize, our ability to instrument our products with our Red Raven IoT offering positions Flowserve to provide true solutions for our customers through monitoring and predictive analytics, but also ensuring that we are in the best position possible to provide aftermarket services and solutions for these customers.

In the second quarter, Red Raven helped one of our customers save millions of dollars by minimizing production downtime. Our predictive analytics notified our customer of an unstable operating condition in their process and advise them to promptly modify the dry vacuum system operating parameters. As a result, we were able to help our customers avoid significant unplanned downtime that would have cost an estimated $1 million per day in lost revenue. Examples like this increasingly demonstrate the value of our digital capabilities and the possibility of providing solutions to drive flow loop optimization. The Flowserve dry vacuum pump offering is now available and ready to be shipped Red Raven compatible.

In conclusion, Flowserve is well positioned for another strong year of financial and operating performance, which supports our second increase to our full year 2024 adjusted EPS guidance. We are confident in the macro backdrop of our served industries as well as in our ability to capture both the run rate business and large project orders under our disciplined bidding approach. We are executing well, and we are excited by the opportunities ahead of us. We are confident in our ability to deliver at least 200 basis points of full year operating margin improvement in 2024 versus the prior year, primarily through our operational excellence efforts as well as the early benefits from our product excellence program.

Lastly, we believe we are ahead on the journey to our long-term goals that we communicated at our September Analyst Day last year. Our near-term focus is to further build upon our operational momentum and continue to enhance our margins with operational and product excellence initiatives. We remain committed to our 3D strategy to deliver growth and catalyze on the macro drivers that exist today.

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We are pleased with our progress in the first half of the year, confident in our ability to build upon the success and are increasingly optimistic about our outlook. We remain committed to further capitalizing on the growth opportunities in the market today, and into the future that will deliver long-term value creation for our customers, our associates and our shareholders.

Operator, this concludes our prepared remarks, and we would now like to open the call to questions.

Question-and-Answer Session

Operator

[Operator Instructions] And we'll go to Mike Halloran with Baird.

Mike Halloran

Let me just talk through the thought process in the second half of the year here and what it means for next year. So certainly understanding these comments that you've been talking about the last few quarters about how the seasonality is a little bit more level relative to history. Could you just give some more context there? And then more specifically, talk to some of the margin moves. It feels like there's some conservatism embedded in the margins in the back half, but I want to make sure I understand how the mix is moving around between aftermarket OE or any other variables that might hit that?

Scott Rowe

Sure. I'll let Amy start and then I'll probably add a few comments. Go ahead, Amy.

Amy Schwetz

Sure. I'll start with revenue. And I think as we've entered into 2024, we are coming off a year with really strong revenue growth. We knew that this was going to be a year about margin expansion rather than outsized revenue growth. And so you're seeing that play out in 2024. The first and second quarter up against easier comps, I would say, are supporting really nice revenue growth, and we'll see that moderate in the back half of the year.

As we think about how this plays out into 2025. These large projects that we booked in Q2 are really going to be a 2025 revenue story versus a 2024. And so although we see those growth rates moderating, we think that we are building the type of backlog that positions us well going into 2025. And then I'll just comment overall that the internal messaging and push is really around leaning into growth in the second half of the year. So continuing to do what we've done, particularly around those higher-margin pieces of the business and you see that coming through in our aftermarket bookings in the second quarter at the level above $610 million.

From a margin expansion perspective, we're really pleased with how we've moved through the second half of the -- or the first half of the year. And I'll comment specifically on FPD, which we really thought had an outstanding quarter from a margin expansion perspective. There was nothing special in there, Mike, but it was a well-executed quarter. So we saw mix shifting slightly favorably for us with the ability to drive aftermarket revenue slightly higher than we expected based on the strength of those bookings. And then our project revenue actually shifted a bit towards higher-margin projects that we see.

So although I don't want to call that 16.9% operating margin as the new normal, I think you will definitely see Q1 margins as the low watermark. And so I would expect for the rest of the year that we'll deliver at sort of a 15.5% operating margins or better in the back half of the year, as we continue to really lean into operational excellence and growing the profitable pieces of that business within FPD.

From an FCD perspective, we performed a little bit better than we thought we would in the second quarter of this year and that was driven in part by operational execution. It was driven in part by a slightly more favorable mix than we anticipated with more services and solutions revenue in the quarter than we'd expected when we began. That said, we still see room for further margin expansion in the back half of the year. That's driven partially by mix and more sort of automation and control valve type work, less project type work. But more importantly, by operational efficiencies we see coming through in the back half of the year. So bottom line margins this year are progressing nicely. The 12.5% that we saw this quarter was very strong, but we see the opportunity, as we've indicated to grow operating margins by 150 basis points or more in 2024.

Scott Rowe

And then maybe the only thing I'll add would be that we've worked really hard to minimize the variability between Q1 and Q4. The last two years, we've come out really strong in the first quarter of the year, including this year. And so that seasonality will still play out. The Q1 will be the lowest of the year for us. Q4 will still be the highest. But the variability between those quarters will be much smaller and we'll continue to work to close that gap.

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Mike Halloran

So second question, Scott, you were talking about a more formal product line review launch, so a couple of questions related to that. One, was that embedded in the expectations you laid out at the Analyst Day? And two, maybe just a little bit more color, and I know you only launched on one, you're broadening it out. But a little more color on what you're seeing or early feedback of what the magnitude of the opportunity might look like and how that could be prioritize your time and capital internally?

Scott Rowe

Yes, absolutely. And so at the Analyst Day, we laid out kind of two big growth levers. One was operational excellence, where we committed 100 basis points to 200 basis points improvement and I'll just start there. That's gone incredibly well. We're seeing that in the results this year and we continue to see further upside to operational excellence.

And then on the product excellence, we also committed to 100 basis points to 200 basis points of margin improvement. And within product excellence, we talked about two categories. One was product management and one was portfolio optimization. And so last year, at the beginning of the year, when we did our reorganization, we recommitted I will say, to really driving product excellence with a dedicated product management organization. And so that essentially unlock this capability to really review our product families and product portfolios in a much more robust fashion within each of the seven business units.

And so the exercise that we kicked off at the beginning of this year in the first business unit is really on the product optimization. And so looking at the different product families within a business unit, understanding what we really like from a margin standpoint, a product SKU standpoint and a customer standpoint, and then taking decisive actions to either invest in products, move products out, raise prices and do all the things that we need to do to maximize the ability to generate value within those product families.

And so the first business unit has been kind of in flight now for about four to five months. We've got clear visibility to the actions and margin improvement and what I'm really excited about is we believe we can move the margins up while continuing to drive focus on growth. And so we don't think we compromise growth with this program, but drive margins up substantially. And so we've got one business unit in flight. We'll launch the second business unit. We've already done all of the data analysis. We'll launch that next month in terms of starting to develop that action plan. And then we've got the third business unit going in flight by the end of the year.

So in summary, we're excited about product excellence. We're still committed to 100 basis points and 200 basis points from the product excellence initiative. And I would say we haven't really seen the benefit of that year-to-date. And so that starts to show up at the end of this year but more predominantly into 2025. And then ultimately, that will continue into 2026 as well.

Operator

[Operator Instructions] And we'll move next to Joe Giordano with TD Cowen.

Joe Giordano

Can you talk about like where the jumping off point from 4Q, right? So the margins of 4Q would be your best quarter. You talked about compressing this. So this -- how do you see that as like compared to it early and early thoughts on margin for '25? It's been a pretty big jump down each year. It's getting less, but like I just want to like bring this appropriately for people as we kind of set new expectations from here?

Amy Schwetz

Yes. So I think, Joe, as we look at finishing up 2024 and kind of moving into 2025, we're going to be focused on the things that we've been focused on the last two years. So really minimizing that differential between Q4 and Q1 and using that exit rate from an OI perspective to really drive performance in that coming year. That said, I don't think that we've fully solved the seasonality issue, particularly as a business that's looking to grow revenue. So I think that we'll continue to see 20 -- the first quarter of the year. We are lightest from both a revenue and an earnings perspective, as we move forward. But as we look at the phasing of some of these larger projects, we'll continue to focus on how do we manage that top line revenue in a way that really maximizes earnings, but also helps us on our working capital journey as well, which the more steady levels of revenue certainly helps with.

Scott Rowe

So I will just add, we're on this progression to the targets we laid out in -- for 2027 last year at the Analyst Day. And so everything we're doing is geared to driving towards the 14% to 16%. We made great progress this year. And so I'd say, while first quarter next year will come down slightly the full year, we should see another substantial step toward achieving these targets.

Amy Schwetz

Yes, absolutely. I think Scott's kind of laid out the road map in terms of how we see that with continued work on operational excellence, where we feel like we've done a lot of work and we're seeing it at the gross margin level, but with product excellence, really, really kicking in, in 2025 and providing us an opportunity to expand margins and get us even closer to our long-term target.

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Joe Giordano

And then it was interesting to see like the targeted divestment there in the quarter. Are there more opportunities for stuff like that? Like how much of your portfolio do you feel like you've analyzed with that sort of lens at this point?

Amy Schwetz

We're going to continue to look through that. And some of the data analysis that Scott referenced is going to continue to help us do this. This was a relatively easy call for us to make. It allowed us to reduce our footprint, it was dilutive to earnings and it was something that once we found the right buyer it was easy for us to make that call. We're going to continue to look for those opportunities, although this was one that was probably a little bit easier than others might be as we continue to get better at both product management and portfolio optimization.

Operator

[Operator Instructions] And we'll take our next question from Andy Kaplowitz with Citigroup.

Andy Kaplowitz

Scott, so you mentioned the bookings pipeline for Flowserve is up 8%, I think. So maybe you could elaborate on that pipeline. Do you still see other large projects out there in addition to what you booked last quarter? And then do you think book-to-bill can still average over 1 over the next few quarters or at least in the second half of this year?

Scott Rowe

Sure. Yes. In the prepared remarks, we did say the project funnel is up 8% year-over-year, giving us really good visibility to project work. And when we talk about the project funnel, it really is projects greater than kind of $5 million. And so we're talking about the larger type projects. Q2 obviously was really good. We had three very large projects in there. I don't see another incredibly large kind of near that $100 million mark in the near-term funnel. But we have a long list of opportunities, let's just call it, kind of $25 million to $50 plus million. And where we see those opportunities, we've got primarily Middle East. And so there's still a lot of activity in the Middle East, Saudi, UAE, Qatar. We've got some work that we've got visibility to in Oman, in Kuwait and so there's a substantial build out there of gas processing and then further downstream activities like refining and petrochemical. And so our outlook there is incredibly positive.

On the power side, we saw our funnel up 22%. That's on the forward look one year out. And so a lot of that activity is around nuclear. And we've got very strong visibility to nuclear build-out in Europe and parts of North America as well. And so, we're pretty excited about the power outlook. And then on the energy transition funnel, it's up 40% year-over-year and kind of that new energy and energy transition for us is the fastest-growing end market. And while the projects aren't in the super large size of kind of greater than $50 million, we do see very robust project activity within energy transition funnel. And so the average size of that would be anywhere between $5 million and $20 million.

So long story short, the funnel is up. We've got good visibility. We believe the full year book-to-bill is greater than 1, which implies kind of a second half of the year at over 1 as well. And I think that given the project outlook in some of the mega trends that we're following, we feel pretty good about certainly, our visibility through the end of the year but into 2025 and 2026 as well.

Andy Kaplowitz

And then can you talk about the return on investment that you expect from the new cryo pump acquisition that you made in LNG, at least versus that $0.05 that you're going to take that you talked about last week in the release, do you see sort of an immediate return in the form potentially more significant wins in LNG, either here in the second half of '24 or '25. How do you -- how should we think about the returns?

Scott Rowe

Yes. I'll talk about kind of our outlook there and then maybe Amy can talk about our returns profile against some of the other acquisitions and things that we look at from a capital allocation standpoint. But on the LNG side, we're very excited about LNG as kind of this transition fuel. It's not going away anytime soon. And with our pumps, valves and mechanical sealing offering, we get all -- we get a front row seat to all of the projects and the aftermarket activity. And when we looked at the portfolio of what we can provide within LNG, what we were missing was the submersible cryogenic pump, and it truly is the heart of the process for both the regasification side and the liquefaction side. So this is something that's been on the product development side for years at Flowserve. It's been something that we wanted to do.

And what we found was kind of a creative path to acquire the in-process R&D or the license and technology of the cryogenic pump. And so we've got some further product development work to do through the end of the year. But we've got a clear path to doing those prototypes and the testing before end of the year and beginning to commercialize the product into next year. We think submersible cryogenic pumps is at least $250 million a year of kind of new equipment, but our pump can also be retrofitted into existing facilities. And so we're actually really excited about the opportunity to put our pump into existing applications that we were not -- we didn't participate in because we didn't have that product. And so this is something that we can easily see a $50 million a year of kind of revenue, maybe not next year, but certainly into 2026 and 2027 and we're excited about the growth of this product.

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Amy Schwetz

And just from a return standpoint, we would look at this through the lens of likely would any sort of inorganic growth. So does it fit the strategy, which Scott's clearly outlined, is it accretive to margins? We believe it will be. And then are the long-term returns there. The one comment that I would make is something like this that we need to commercialize, we would actually expect slightly -- well, we would expect higher returns than we would on an existing business that may have less risk in terms of that commercialization period. So we're really excited about the potential returns that are out there. And in this instance, we are able to finish the acquisition of this in a way that actually sort of limits the risk going forward in terms of commercialization. So something we're very excited about.

And then the last comment that I would make is what we've not included in the economics of a transaction like this is the ability for this product to help us lead pull-through of other Flowserve products into LNG facilities, which is an added benefit, we believe it may provide longer term.

Operator

We'll go next to the line of Deane Dray with RBC Capital Markets.

Deane Dray

Scott, I'm always interested in hearing your take on the composition of the orders in the quarter. You highlighted the three large ones. But just looking deeper into that order book, what's your take in terms of the size and what that means? And then can you also give some color on the record aftermarket, is that the installed base coming through? Or are you doing something extra in terms of getting your access to those aftermarket orders?

Scott Rowe

Sure. I'll start with projects and then I'll talk about aftermarket and quite frankly, after a market was the highlight. So I'll spend a little more time on that. On the project side, we had three large orders, roughly $200 million across all three of those. They're in the Middle East, mostly around gas processing but also a chemical award. And again, we've got incredibly strong connections in the Middle East. We have a strong presence with the ability to make pumps, valves and seals in the Middle East, and then we've got an amazing team that's doing a good job with the end users there.

We've got continued outlook and visibility to projects in the Middle East, and we're confident in our ability to continue to drive that business forward. When you get beyond those three awards, we did have a long list of project awards in kind of the $5 million to $15 million range. We had significant power bookings $70 million plus on the nuclear side. We had a lot of energy transition type work. And so a really nice balance across industries within the project bookings.

But let me turn to aftermarket. We booked $614 million in the quarter. That's the highest level of aftermarket bookings we've ever had. It's the seventh consecutive quarter now over $550 million work. And I'd say there's two big drivers here. One, on the market side. Clearly, high utilizations across where our installed base is, so refining plants -- petrochemical plants, chemical facilities, power facilities, all running at reasonably high utilization levels, which is driving parts and service on our side. There's also some pent-up demand just -- I don't know if it's the COVID side, but just some deferred maintenance that's still coming through the system. And so that's helping us as well. But I'd say the second big driver for us was -- is really on the back of our new ore design last year, where we clearly segmented services and solutions in the pumps division and we segmented in a separate BU within our valve business.

And so what we've seen by this enhanced focus is our ability to move up our capture rate on our installed base. And so through deliberate actions around quoting quicker, providing shorter lead times being more responsive in general, the mantra, quite frankly, is speed wins in our aftermarket business and so what we're seeing is our capture rates continue to move up within the aftermarket business. And so if we look forward, obviously, record bookings at $614 million in Q2. But we believe that we can continue to move this up. Our capture rates still have opportunity for improvement as we continue to drive speed in all aspects of the aftermarket business. We believe that we can continue to grow this side of the aftermarket side of our business.

And so we're excited about what the teams have done. The new org design is, quite frankly, is unlocked some of this capability and provided more of a global perspective across both valves and pumps, and we believe we can continue to drive initiatives that lead to enhanced growth within the aftermarket business.

Deane Dray

That's exactly what I was looking for in terms of what was the drivers around the capture rate. And then second question, nuclear has come up a handful of times. You talked about opportunities and some activity in Europe and North America. Is there anything that you've seen so far related to power needs for data centers. That's -- we're hearing a lot more of that as an opportunity as Amazon making an investment in a nuclear plant. Anything on the small modular reactor side? And what are your opportunities?

Scott Rowe

Sure. I'll start power and general, I'll go to nuclear. I'll end with SMRs or small module reactors. So power outlook for us is we feel pretty good about what we're seeing there. I'm laughing because last year at our Analyst Day, we committed to -- was at 3.2%, Jay. We committed to 3.2% on the forward look. Clearly, we were understated there and missed some of the trends on the data center and AI.

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We'll put out some kind of new work on what we see that growth rate is. But power for us is a $400 plus million business a year. We're in pretty much all of the power applications, whether it's coal-fired power plants, whether it's natural gas, nuclear, everything else. So we have a massive installed base. And what we believe over the next couple of years is an inflection to increased power demand, both in the Americas and in Europe. Ultimately, we see that across other parts of the world. But after decades of power demand being relatively stable, we're now seeing, what I'll call, reasonably substantial growth and that growth is driven on the back of everything being electrified and this new kind of data center demand driven on the back of artificial intelligence. And so we feel that the outlook in power is substantial.

We see existing power generation facilities, we see the utilization rates start to increase. We're seeing plans for expansions and capability or increases in generation within the U.S. And then we're also seeing substantial build-out across Europe and other parts of -- well, India and other parts of Asia Pacific as well. And so we're excited about what we can do in power. We've got a pretty good lineup of products across pumps, valves and seals that supports traditional power and nuclear.

Then on the nuclear side, we believe that this is an area to provide incredibly clean and reliable and safe fuel regardless of any condition. What we're seeing is expansions in Europe, primarily on the back of EDF, the French nuclear authority that has the license for a lot of different nuclear applications in Europe, and they're moving into India as well. We've got strong relations with them on both our pumps and valve portfolio. And we're pretty excited about their plans as they go forward and pulling our product into their expansions.

And then also in Europe and certainly in the Americas, what we're seeing is life extensions on existing nuclear assets. And so they're taking the existing life of that asset and adding a 20 or 30 year life extension to the nuclear facility and when they do that, it's a substantial aftermarket effort on our side to rerate pumps and valves and replace a lot of the existing equipment to make sure that our equipment is working for the full life of that extension that they've defined.

And so overall, we see nuclear generation as something that will continue to grow. It doesn't happen fast, but we are now seeing substantial signs in our forward funnel of significant growth as we go forward. The power funnel overall is up 22% year-on-year. Our nuclear funnel is kind of right at that 20 plus percent a year. And so I think you can expect us to talk about nuclear for many quarters to come as we go forward.

And then on the last question with small modular reactors. We are participating in several of the kind of the R&D or the technology development to support SMRs, but my view is that's still many years away until we get to a commercialized product and that becomes a meaningful part of our business.

So what we're doing is we're working with a very select few players that we believe we're in an advantaged position with their technology. And our hopes are that by working with them, we'll get our pumps and valves spec into their process. But again, I'm not optimistic on the time line, that's probably still kind of 5 to 10 years out until it's commercialized.

Amy Schwetz

One comment I'll just add into that is that the hype is happening. So the first half of the year, we've seen a 20% increase in power bookings year-over-year. So this is not just a trend that we see playing out in the future, it really started in the first half of the year.

Operator

We go next to the line of Damian Karas with UBS.

Damian Karas

I'm hopping on late from another call. So probably, if you touched on it, but I didn't hear anything about price. So I was wondering if you could maybe just give us some perspective on the pricing environment you're seeing. How much are you realizing to date? And in terms of the funnel, the order, the bookings, are you still kind of seeing some incremental value from kind of that value-added pricing or is that mostly normalized?

Scott Rowe

Sure. I'd say we're in a much better place than we've been in the last two years, and I'm happy that this hasn't been the first question out of the gate. But I'd say we're doing a much better job on pricing. Our cost inflation has moderated or subside in many parts of our business. We did announce the price increase at the beginning of the year, roughly kind of what I'll call more normal price increase in that 4% to 5% and we believe that we're doing a much better job kind of realizing that price increase, making sure that it sticks and making sure that we're on the positive side of the price/cost curve. And so that would be for our general business. The mechanical seals are kind of run rate valve business and then the more industrial-type pumps.

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And then on project pricing, we've talked last quarter and even the quarter before about our selective bidding and making sure that we get the margins that we deserve for large complex projects. And what I would say is that our team has done a really, really good job working through a very complicated landscape with EPC and end users, but we're really making sure that we can deliver the price and the margins that we think are acceptable for some of the risks that we take on in the larger projects.

And I'd say the overall project pricing environment has gotten better. It's still not perfect, but it's allowing us to continue to walk up our project pricing. And so overall pricing environment has improved substantially from a year ago. We continue to see this as constructive as we move into the back half of the year and into 2025.

And then I'd just say as part of the product excellence initiative, pricing is a big component there. And I think what you'll see over the next year or so is that we get a lot more disciplined on pricing. We'll be more specific in product families and customers on pricing and so just a more mature approach to pricing as we kind of roll out the product excellence initiative.

Damian Karas

And then you called out the 3D bookings growth above 25%. So I'm kind of curious on the 3D. Maybe you could just give us an update on Red Raven, how the adoption is tracking? Any updated views on what you think is possible there?

Scott Rowe

Sure. Yes. We continue to make really solid progress here. I do wish it was faster. We're up to kind of 2,250 assets that we've now instrumented. What I would say on a very positive note is the system is working incredibly well. The customer feedback is really high. And what we're finding is when we do instrument pumps or valves within a customer facility, we typically get repeat orders or asking to kind of add more assets to our monitoring program and our prediction.

And then the other thing I'd say is the algorithms that we developed, it's been almost kind of five years now. They continue to get better with all of the data that we're collecting and what we're finding is that the system is doing a really good job on predictive analytics and allowing our customers to avoid unplanned downtime.

So in my prepared remarks, we talked about this happening with a dry vacuum product, where we saved the customer $1 million a day of potential lost revenue because we're able to alert them to a process condition that they weren't aware of through their traditional DCS system. And so I'm still very excited about this. I do think if we fast forward 10 to 20 years, I think most, if not all, full control will be instrumented. So I feel like we're doing the right things. I also feel like we're at an inflection point in terms of Red Raven adoption. We've got some great case studies now, and I think we'll see this growth rate pick up even more than what it is.

And then finally, I'll just say we believe that the digital side, the ability to instrument our equipment, the ability to understand kind of flow conditions and provide these predictive analytics truly allows us to be a much better solutions provider when it comes to full control. And so when we add this system to a facility, we become very close with the operating team, and it allows us to pull through parts and incremental services. And so we're already seeing a tremendous benefit on our aftermarket when we do have Red Raven installed at sites. And so we're going to keep focusing on this. I expect the inflection rate to come up, and I do expect us to talk more and more about our ability to generate solutions within a full-loop environment.

Operator

We'll go next to the line of Nathan Jones with Stifel.

Nathan Jones

I wanted to go back to gross margins. I guess the first question here is, if I look back at 2019, you had gross margins heading in the right direction at that point. And then obviously, COVID derailed everything. And we saw compression from there. In '23-'24, you're back to a point where revenue is higher than it was in 2019, but gross margins are still 100 basis points or so lower. Can you talk about what the difference is in the business today versus five years ago that still has gross margins slightly below where they were in 2019 on higher revenue?

Amy Schwetz

So I'll start with -- I mean, we think that we can get back there, Nathan. And so I appreciate the question in terms of how we're thinking through the operating margin expansion that we've got embedded in our long-term targets. So we've talked this year about expanding gross margins 150 basis points or I'm sorry, expanding operating margins by more than 150 basis points. As you can see in Q2, the majority of that is coming from gross margin expansion. And so we believe that the levers that we've outlined in terms of operational excellence, which is already showing dividends and product excellence can work to further expand those margins and get us back to those 2019 levels or, frankly, higher than that as we move forward.

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The one thing that I would point out with respect to 2019 is operating margins in 2019 were 11.3% versus the 12.5% that we saw in the second quarter of this year. So I believe we'll end 2024 at an operating margin higher than what we saw in 2019, which frankly puts us on solid footing to continue to deliver value to our shareholders both via gross margin expansion and cost control within other cost categories to make the company stronger than what we've seen in those previous years.

Nathan Jones

I guess the follow-up then is going to be gross margin. Just specifically on FCD, because if you look back historically, that's where gross margins have typically been higher. FPD is actually kind of back to where it has been historically on gross margins, but FCD is the one lagging. So can you maybe talk about if there's something structural that's changed in the business? You used to be able to kind of get towards mid-30s gross margins for FCD. And if there's nothing that structurally changed, what's the path to getting that business back to mid-30s gross margin?

Amy Schwetz

Yes. So I would say our long-term targets for FCD from an operating margin perspective, we're a little bit lighter than where we've seen that historically. And that is due to a mix shift in that business, both in industry, but in the balance that we're providing. So more of a focus on really the isolation valve piece of the business, and we want to continue to grow our ACV, our automation business, but isolation balance have been growing a little bit faster. So that mix has been impacting us. And I'll just comment as we talk about power generation, that is isolation valves that are driving some of that growth that we see over time. That said, we see a tremendous opportunity for growth in the valve business moving forward.

And frankly, FPD, we're not stopping on margin expansion, but we're at our long-term targets in the second quarter in terms of operating margins. So what do we need to do with FPD. The start is in the second half of the year, the operational excellence and execution will get better. We'll see that kick in, in a bigger way than what we've seen in the first half of the year. And as Scott pointed out, product excellence is really going to be a 2025 story, but that journey starts this next quarter for our valves business. So we're confident that those margins will be expanding not just in the back half of the year, but as we move into 2025.

Operator

We go next to Brett Linzey with Mizuho.

Erick Look

This is Eric Look on for Brett Linzey. Focusing on Asia-Pacific, it's nice to see a tick up 5%, improving from last quarter's 1% growth. How should we think about China's contribution to the region in terms of sales and bookings and maybe some color on Asia-Pacific outside of China as well?

Scott Rowe

Sure. Within China, we've got two large facilities that essentially do China for China, both on the pump side and the FCD side. And so we feel like we're reasonably well positioned there. I would say, at this point, we're not investing in China, but those teams are clearly geared towards winning projects within China and then I'd say probably more importantly, capturing the aftermarket within our installed base. And so, I'd say that's kind of the focus area for China at this point.

And then broader Asia-Pacific, when we look at that year-over-year, we look at it even compared to years ago. That business is slightly down. I'd say it's the investment across Asia-Pacific is a little lower than what we would expect. But I do still -- I believe that there is optimism in terms of projects and run rate increases, as we kind of move forward into 2025 and 2026. And so well represented in Greater Asia-Pacific. We've got teams in most countries. And I think we've got an amazing installed base. And so the aftermarket business continues to perform reasonably well, but we haven't seen the project business like we expect. And so again, I think on the forward look, I think it comes up from here. But the China growth and commitment is not where we're going to put our focus and efforts in the foreseeable future.

Operator

We'll take our final question today from Joe Ritchie with Goldman Sachs.

Joe Ritchie

So Scott, your comments on the aftermarket business for like super positive. And I'm kind of trying to think through this beyond 2024. And so is it right to consider $600 million is kind of like the new quarterly run rate, and that's something that we should basically capitalized into next year? Or just any thoughts around the sustainability of the current orders and how that translates into revenue going forward?

Scott Rowe

Sure. Like I said, we haven't seen anything crazy here or one-off or anything that's like juicing the bookings in the second quarter. And what we've seen, if you kind of projected this out over the last 18 months quarter-over-quarter, what we've seen is just nice, steady progression here. And again, I think there's a market element to this with higher utilization rates, a little bit of pent-up demand but not a ton. We did have spring turnarounds. And so there was an uplift in the second quarter around that. But I'd say overall, the market activity should continue as we look into the forward quarters here.

And then secondly and probably the biggest driver is the new organization design creating enhanced focus on both pumps and our valve business to really make sure that we're winning our entitlement here. And so we have a massive installed base of pumps and valves around the world. We do track our capture rate, our ability to get the aftermarket on that installed base and I'd just say there's lots of room for improvement on moving this capture rate up. And with all of the initiatives around being more responsive, quoting quickly, shorter lead times, what we're seeing is those capture rates move up. And so, I think this is sustainable. We may tick down a little bit maybe in the third quarter or something as we look forward. But I'd say that overall trend in growth rates should continue at a nice steady progressive rate as we go forward.

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Joe Ritchie

And then my one follow-up for Amy. Just on free cash flow for the quarter was a tad bit lighter, but I know that there's sometimes timing issues. It seems like receivables uptick this quarter. So is it right to just kind of think about that as a timing issue? And then what are just your expectations for free cash flow for the year?

Amy Schwetz

Yes, absolutely. So we knew that Q2 was going to be a challenge from a free cash flow perspective. The accounts receivable build we saw was not as a result of any collection issues but more timing related in terms of when those products went out the door when we hit milestones on percentage of completion projects. So we think we're set up for a really strong second half from a cash flow generation standpoint. And in fact, really picked up our guidance a little bit on our first half results. So we were previously anticipating kind of 70% to 80% free cash flow conversion in the year. And we're now thinking more of some level of 80% or better for the full year.

So it points to a really strong cash flow generation in the second half of the year as we collect on the strong revenue conversion that we've had in the first half of the year and expect in the second half and importantly, continue to make progress with respect to inventory management. So we're excited about where we're going, both with primary working capital management and free cash flow generation more broadly.

Operator

This concludes today's conference. We thank you for your participation. You may disconnect your lines at this time.

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