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Carrier Global Corp. (CARR)

Baird Sustainability Conference

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MANAGEMENT DISCUSSION SECTION

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Great. Well, why don't we get started? So, shoot, good morning, everybody. Thank you for joining us at Baird Sustainability Conference. I'm Tim Wojs and I cover commercial and residential building products here at Baird. And we're very delighted to have Carrier with us this morning. They're one of the largest HVAC companies globally. But they're kind of the new kid on the equity block having spun out from UTX nearly a year ago. And Carrier really fits the sustainability theme well just given the drive globally to reduce building emissions and something we're going to really talk about today in more detail.

So joining us from the company are President and CEO, Dave Gitlin; SVP and CFO, Patrick Goris; and then VP of Investor Relations, Sam Pearlstein. In terms of format, we'll have Dave give a few prepared comments, state of the union, if you will, and then we'll run through Q&A. So feel free to email me questions if you have any and I'll do my best to get them answered.

And with that, I'd like to turn over to Dave. Dave, the floor is yours.

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

Tim, thank you so much for having us. Appreciate that. Look, we love the theme of your conference because at Carrier, as you kind of said, we're at the intersection of really three critical societal needs, healthy building, cold chain solutions, and the theme that you have here today is sustainability. So with your permission, Tim, let me just say a few quick words on each of these because these three themes, they're multigenerational challenges. They're not fads during the pandemic. In fact, they've been with us for decades. They'll be with us for many decades to come. What COVID has done is really shined a light on their criticality.

So, first, if you take healthy buildings, trusting that the air that you breathe indoors is safe is deeply important. It's always been important. You wouldn't eat dirty food or drink dirty water. But even though we breathe 2,000 gallons

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of air per day, we breathe dirty air all the time because we can't see that it's dirty, so we're going to make it visible. So, before you make a restaurant or a hotel reservation or you drop your kids off at school or you come into the office, you can have visibility to the air quality and then if the air quality is not what it should be, we'll use our new digital offering to tie into the building control system to auto correct any deficiencies.

We need to get our kids back in a school and our customers back in indoor environments. So, we've been working with the likes of Cushman & Wakefield, the American Hospitality and Lodging Association. We're partnering with WELL to help get their customers WELL certified all because we want to play our part to give customers confidence and to make it safe for them to re-enter indoor environments.

And you'll see the same with cold chain. For many years, we've had problems with vaccine distribution. In fact, today, 25% of vaccines that get distributed are wasted in part due to issues with cold chain distribution and now with COVID and you have billions of us waiting for our turn to get the vaccine, we know that we cannot let that happen. But it's been happening for decades. It's a problem in search for a solution, of course, right now that's immediate, but a sustained solution. And it affects not only vaccines, but also food distribution.

Tim, today, one-third of all the world's food that gets produced never gets consumed in part due to issues with cold chain and spoilage issues. And by the way, one in nine people go to bed hungry every night. So, you can think about the impact that we could have on global hunger if we could eliminate food waste. So, we need to address the cold chain challenges. I'm very excited about our new partnership with AWS where we're launching our new Lynx platform because digital solutions just like with healthy buildings will be critical to addressing the gaps in the cold chain today.

And then, the third, the theme of today's conference is climate change. Of course, your audience knows it's been a severe problem for years and the good news is thanks to this conference, Bill Gates' new book, Larry Finks' letter, senior, political and business leadership globally, it's now getting a lot more focus. And you had mentioned it up front, Tim. But our industry frankly is a major part of the problem which means that we need to be a major part of the solution. 15% of all greenhouse gas emissions come from HVAC systems. And demand, of course, for air conditioning is only going to increase in part due to climate change, in part due to the growing middle class.

Frankly, it's a bit of a vicious cycle because climate change will drive the need for more air conditioning. More air conditioning will lead to more greenhouse gas emissions. You've got about 2.8 billion people living in the hottest parts of the world and less than 10% of those people have air conditioning today. And you think about the United States and Japan, more than 90% of us have air conditioning. So HVAC, it's a great key contributor to greenhouse gas emissions today. Demand is going to grow. So we need a step change in technology and buying patterns.

And it's the same on the cold chain side. 12% of global emissions today come from energy used to produce food that never gets consumed. In fact, if food waste were a country, it would be the third largest emitter of greenhouse gases behind the United States and China. So we're perfectly positioned to move the needle in a profound way and we can get into the Q&A. But more energy efficient HVAC systems, addressing cold chain challenges, and we've committed to reducing our customers' carbon emissions by more than 1 gigaton, more than 1 gigaton by 2030. That's a billion metric tons and that's the annual greenhouse gas emissions of Japan.

So it's not only good for the planet and it's good for generations that come after us. It's good for business. Our customers expect creative solutions here and we're spending billions of dollars to innovate in this critical area. Our customers expect creative solutions here and we're spending billions of dollars to innovate in this critical area. So a very timely conference, Tim. We appreciate you're having us and please to get into the Q&A.

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QUESTION AND ANSWER SECTION

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. That's just a great introduction. I appreciate that, Dave. If anybody has any questions, you can email me at twojs@rwdbaird.com. Maybe just kind of dovetailing off that last comment, Dave, on your 2030 goals, you have set some 2030 ESG targets and I think it's around planet, your people and communities. And could you just talk a little bit about the key aspects of those and how investors and stakeholders will really be able to kind of track Carrier against your commitments? And maybe if you could kind of marry that with some of your 2020 goals that were set a few years ago and how you've progressed relative to those.

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Sure, Tim. Let me start with the 2020. In 2015, we established goals for 2020 and we actually met or, in most cases, we exceeded all of them. We reduced greenhouse gas emissions by 19%. The goal we had was 15%. A lot of it was using – putting our money where our mouth is with more Carrier energy-efficient chillers, our building management system, we have an eco-energy business in-house, all played a part of the solution. We reduced water consumption. The number was 44% and we exceeded our goal that we had set of 25%. Hazardous waste 23%, and our goal was 10%. Recycling, we improved our recycling rate by 94%. We had set the goal was 90%. So we really were very pleased with the progress over the last five years.

But when you look ahead to our 2030 goals, I would characterize them more as revolutionary versus evolutionary. I mentioned this 1 gig – more than 1 gigaton. It's not only a big goal but I will tell you that we have high confidence in it. And we also targeted carbon and water neutrality in our operations, zero waste to landfill across our operations. Of course, we're going to really lean into diversity and inclusion. So the way we track it is that we have an ESG control tower with all of our committed metrics, we have owners and we treat it just like we would financial or operational commitments. We have owners, actions, dates and then we track it on a monthly basis and we're going to disclose our progress in our ESG report annually.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. That's great. And then thinking about kind of energy sustainability, I mean, really kind of two aspects there to maybe talk about. So first, what are the actions internally that Carrier's taking to reduce your own energy consumption and waste? And then what are some of those incremental opportunities over time? You talked about zero waste for landfill and more recycling. And then second, and maybe this is more appreciated by investors, but could you just talk about some of your internal initiatives basically by creating more efficient products and really kind of lowering the carbon emissions that your customers are generating?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Sure, Tim. And let me hit the first one first which is when we think about our own operations we talked about carbon and water neutrality in our operations and it really comes from leaning into energy-efficient technologies. We're investing in renewables, closed loop water systems. So before COVID, I'll give you an example. I was in our Montluel facility in France and we renovated our entire test lab to use our new high energy – high efficiency AquaForce chiller and we used our ALC automated logic controls system. So we have a variable speed chiller which is then inherently optimized to the energy needs that you need in the lab.

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And we also use a one – a GWP of 1. It's an HFO. So we had been using a GWP of north of 1,400 and we've reduced that to a GWP that's less than 1. And we saw a 25% reduction in our annual energy consumption there. And we did something similar in our facility in India and that was a combination of renewables. We invested in solar, energy efficient compressors like I just described. We converted a diesel generator to natural gas, installed LED lighting like we do in a lot of our facilities and the team there saw a 40% reduction. So, a lot of focus internally.

But with our customers, it's a lot on new product introduction. If you look at the energy efficiency of commercial HVAC over the last four decades, we've improved the efficiency of our chillers by about 15% per decade and we're going to do the same this decade. So, it's all design modification, variable speed fans, energy recovery. So, one example, Tim, is our AquaEdge 19DV chiller. It captures waste heat, it reuses it and then it can essentially provide free cooling because it uses ambient cooled air and it bypasses the compressor and we also use a low GWP refrigerant there as well.

And we're seeing the same in resi. When I moved into my place here in Florida, we put in our Infinity System and it's 26 SEER for air conditioning, 24 SEER for our heat pump. So, we're really leaning into that on the air conditioning side and we're doing the same in our refrigeration business. We have a unit that we use for container that's just starting to get a bit of traction. I'd like to see more, but with our natural line unit, this uses CO2. It has a GWP of 1 for our new NaturaLINE container refrigeration unit. And in ETT, we're leaning into obviously the electric theme overall. So, we just introduced our Vector eCool unit, which is the first all-electric engineless system. So, what it does is it converts kinetic energy from the trailer axle and the brakes into electricity. And then, you store that electricity, that power into a battery pack that really powers the refrigeration unit.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Well, that's pretty innovative. Yeah, that would be nice to see some more progress on that.

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Yes.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

I guess on refrigerants since you mentioned it, there's a question here from the audience. Could you just talk about your view and some of your investments around refrigerant development and kind of alternative refrigerants overtime?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Sure. I mean we've looked at alternatives like the HFOs, and we're starting to use that. Of course, you're starting to see in resi a little bit more usage of A2Ls. As we look out at what we thought was going to be 2023 for the new refrigerant requirement in the United States from CARB, it looks like that's more like 2025. So we're still experimenting with different alternatives, but it looks like that's mostly going to – most likely going to be an A2L solution. So, we're investing a lot in with our partners in new refrigerant technology and whether it's an A1, A2L or various alternatives like CO2, we want to really span the gamut of all the possibilities.

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Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. That makes sense. When we think about energy efficiency just in terms of the conversations with the customer, could you maybe talk a little bit about how that's evolved over the last five to 10 years in terms of just how customers are thinking about energy efficiency? And how would you characterize the importance of that on a customer level today, particularly with carbon footprint reduction and the higher cost of actually reducing those carbon footprint?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Well, you nailed it, Tim, in the question because our customers are out there in traffic and in public with their own commitments. So they really have a pull for more energy efficient solutions, not only because you can save money over time with reduced energy, with more energy efficient solutions, but because they want to do what's right for the environment as well. But in many cases, as you just said, it's more expensive upfront.

So what we have seen is that public policy can play a huge role here. You look at the new requirements in New York, Local Law 97 is going to place a carbon cap on most buildings that are larger than 25,000 square feet. And there's about 50,000 residential and commercial properties across New York that fall into that category. So we're seeing customers there show interest in improved chillers and starting to invest in more electric heat pumps rather than – and they don't want to buy carbon credits. I think they'd rather see more energy-efficient product in their buildings.

And we saw it in China. China's actually done a lot of government incentives to move people from coal to electricity. And we saw that, as we upgraded out to a more modular heat pump in 2020, we saw a big increase of sales of those heat pumps in China. And I'm very optimistic and hopeful that the Biden administration will accelerate some of these climate policies as well. You think about the home, 50% of the electricity in your home comes from your HVAC systems, 50%. So the typical air conditioning sold today is usually at an entry level. That 13, 14 SEER level, it's about half as efficient as – even if you can get up to the 16 to 18 SEER range. Put aside the Infinity System at 26 SEER, even if we could get customers more to like that 16 SEER range, it could have a huge impact.

We talk often about electric vehicles and the government has given incentives for $7,500 per electric vehicle. But when you think about buildings for your home, they've given credits for about $500, not $7,500, about $500 per unit, on the commercial side, a tax deduction for efficiency improvements of like $1.80 per square foot. If we just increase those credits for the home, for moving to higher SEER units, for commercial buildings, the amount of tax deduction you get per square foot, you could, even a modest credit, could reduce greenhouse gas emissions by hundreds of millions of metric tons. So we're very hopeful that government can play a significant role here.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Okay. And just based on your intel and kind of your feelers out there when you think about kind of a new green deal that could come through with Biden. The question we get the most is how does the minutia in the detail – the devil's in the details and the minutia, how do you think that goes to market, I guess, if you will? Is that going to be run by state? Is that going to be some sort of federal tax credit, any sort of kind of feeling or sway in terms of how you think that gets implemented?

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David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

It's too early to say. I do think that a national policy will go a long way for the industry. When you have different states with different requirements, for example, if all states are transitioning to different lower GWP refrigerants at different times, it can create challenges for the industry. So what you do want is more uniformity at a federal level and you do want to see more tax credits and incentives at a federal level that really cuts across the country. We'll have to see.

If you look at the $1.9 trillion stimulus package that Biden has there today, the good news for our industry is you do have money in there for vaccine distribution, about $20 billion. You have about $170 billion for schools reopening with money for ventilation. There's $350 billion for additional state and local aid. So we'll have to see how that all – if the $1.9 trillion stimulus package goes through, how that gets applied federally and locally. But I do think there's a lot of momentum really across the political spectrum or for more focus on energy efficiency. So we are hopeful that there is – that the administration does lean forward in this area.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay, yeah. I mean, it seems like a very big opportunity for you guys. So hopefully that's true.

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Yes.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Maybe just on social and kind of the governance aspect, I mean, I think HVAC investors have generally concentrated on the E in the ESG, but from a social and kind of a governance perspective, could you just talk about what you've done in those two areas since you started at Carrier?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Yeah. Tim, if you look at D&I, I would tell you that 2020 was the most profound year that I can recall, really a true reckoning, I would say, within Carrier and I think corporations really across the country that there was a recognition that we need a significant change. We've made progress over time. You look at Carrier since 2017, we've improved to now. We have more than 30% of our executives are female. We've committed through Paradigm for Parity to get that to 50% by the end of this decade, which we absolutely should be able to do. And 50% of my direct reports are diverse, but honestly we have a really long way to go.

So we've really come up with a multipronged strategy this year. We partnered with a couple of HBCUs, Spelman and North Carolina A&T. We've done a lot through the Carrier way to try to create a truly inclusive culture. We're not there. We're on that journey, but we're excited to really lean into it. And the same is true on governance. I think that's an area from UTC that we inherited that was really a best practice within UTC. Governance, as you know, and the focus that UTC had that we've now carried over, it's kind of part and parcel of who we are that we really – will remain a big part of who we are.

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Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay, great. And then maybe just lastly on some of the ESG topics just in terms of kind of incentive compensation or management targets, are there any sort of – has there been any sort of incorporation of ESG practices into kind of long-term incentive plans or any consideration?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

There has been. What we have said is that ESG is an important consideration for IC. It can – you have – it's fairly formulaic and we've actually changed some of our IC after the spin from UTC of how we want people to be focused. So at UTC, for example, there was not a sales component of incentive compensation and now that's going to be a significant piece of our IC going forward as we emphasize top-line. Of course, you still have operating. You have your EBIT and you have your cash flow. So, it is a little bit formulaic that's tied to the financial metrics that we've laid out for our investors. But you can use discretion up or down and one of the big pieces of discretion will be your ESG target. So when I meet with my direct reports and we review our performance as a team, we not only look at the financials, we look at how folks are doing on diversity metrics, our environmental metrics and commitments that we've just laid out here today.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. That's great to hear. Maybe just transitioning a little bit to some of the kind of normal kind of operational business questions. I mean, it's been about 11 months since the spin and you spun out into probably one of the craziest markets of all time.

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Yeah.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Maybe as you kind of look back and I'm sure that was fun but, I mean, as you kind of look back, what are the areas that you exceeded expectations kind of relative to the spin and maybe where there's some more opportunities as you kind of look forward?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Well, I look back at 2020 and I'm incredibly proud of the team. I think the entire leadership team, but all 56,000 people really stepped out. We kept our operations running. We supported our customers. Of course, we had some challenges, but we went to great lengths to support our customers. We gained share in key areas like resi and applied, light commercial. We launched the Carrier Way which is our new culture, a new operating system that we call Carrier Alliance, I mean, a new partnership with our supply chain. Carrier Excellence is what we use in our operations.

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So a lot of new infusion of talent and culture and operating systems and killing some bureaucracy into the system that I think really took hold for the good of our people and our customers and our shareholders. And we went to great lengths to improve our balance sheet that we can get into more detail on that, but we started with about $10 billion of net debt and ended the year with about $7 billion and we sit on $3 billion in cash coming into the year. So, very pleased on a lot of levels.

But the one word I think of when I think of Carrier right now is opportunity. I mean, we have so much runway in every area when we look at our business. We've laid out our three pillars of growth and we still have tremendous opportunity to grow the core and product adjacencies and you really lean into the aftermarket and digital. I would call all three of those areas early phases of development. I mentioned healthy buildings, cold chain, sustainability, huge macro opportunities for us. I'd call all of them early phases. Digital tools, we have a long way to go as we look at growing our aftermarket and really applying for the digital tools for differentiation.

On the cost side, we're pleased with Carrier 700 but that's a program that we've got to continue to lean into and [audio gap] (23:19-23:22) Carrier is still too complex, so we have a long way to go with simplifying the business number of legal entities and real estate and ERP systems and we still have a lot of runway on our balance sheet and capital deployment and portfolio optimization, things that we have to assess whether they ought to be part of the portfolio and things we can add. So, great progress, but lots of runway.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah, that's great, that's great. I mean, the flexibility you showed this year was pretty incredible, so that's good to see. Maybe in terms of Carrier 700, if you could just maybe discuss how that has evolved. It started at Carrier 500 and now it's Carrier 700. I guess once we kind of get to the end of Carrier 700, how should investors think about kind of cost and productivity on an -- on a longer term basis as well?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Yeah. Do you take this or I could take it? As you said, we started we were in the 500, 600 range and we're now at 700. I think the big increase that we saw has been on supply chain. Productivity is kind of a way of life. You expect a couple percent a year. I will tell you that in 2020 and 2021, it's tricky right now. I mean, there is a lot of – the operations team is constantly having to stickhandle its way through some supply chain challenges. So, productivity, I'm very, very confident as we roll out Carrier Excellence, that will continue to take hold. As we roll out more automation, that will take hold.

But right now on the productivity side, our number one focus frankly is supporting our customers. I mean, we saw on this storm last week that there were challenges, there were sites going down, sites that rely on Texas natural gas that got impacted. So, some short-term perturbations, by and large, we'll be fine. We'll manage our way through the challenges, but that's just some that we have to stickhandle our way through. I'd say supply change, just huge opportunity there. We reduced from 4,000 suppliers to about 3,500 on the direct side. Opportunity there as we continue to partner and you'll see more and more announcements sort of along Carrier Alliance partners that are on this journey with us. Like I said, automation and then the big one – not the big one, but a big one is going to be G&A.

We at Carrier just have – we have too much G&A. There's no other way to say it. But we're trying to reduce it not through just giving out head count targets but through a systemic way of creating low cost centers of excellence we've established for globally. We're going to be moving in a very systematic way towards the COEs. So I do think G&A is a big opportunity as well.

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Patrick P. Goris
Senior Vice President & Chief Financial Officer, Carrier Global Corp.
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The only thing I would add -- the only thing I would add, Tim, is that it doesn't stop after Carrier 700. Continuous improvement doesn't stop when the program comes to an end. So there will always be a focus and it continues to drive improvements in our cost base and efficiencies.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.
Q

Okay. Okay.

Patrick P. Goris
Senior Vice President & Chief Financial Officer, Carrier Global Corp.
A

We might call it something else. But there is something after Carrier 700.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.
Q

Carrier 1 billion sounds pretty – has a nice ring to it, so.

Patrick P. Goris
Senior Vice President & Chief Financial Officer, Carrier Global Corp.
A

I like the way you think.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.
Q

Maybe on the investment side, could you maybe talk a little bit about how you're kind of basically taking some of these cost savings and reintroducing that into investment spend? And when you see kind of the spin off, there's technically kind of a reinvestment period that needs to be made and you're trying to figure out what the right reinvestment level is. So if you can maybe just talk about where you are on the investment spectrum and kind of where you think you can get to or when you think you can get to that kind of investment flywheel where the investments you're making are starting to contribute to growth and productivity and things like that on a pretty regular basis.

Patrick P. Goris
Senior Vice President & Chief Financial Officer, Carrier Global Corp.
A

Yeah, Tim. So we, early on, we sized the level of investments required at about $300 million over three years. You may recall last year we invested $100 million of that. That was very much back and loaded. That was about $25 million I think in the third quarter and then $75 million in the fourth quarter. So we have increased Carrier 600 to Carrier 700 but actually we have not increased our overall investment target. So the investment target remains at about $300 million. The timing of that $300 million is a little bit different than what we initially thought. So initially, we thought $100 million each in 2020, 2021, 2022. We now decided to pull in to accelerate $50 million into 2021. So we now think it's going to be closer to $100 million last year, $150 million in 2021 and then we expect another $50 million next year. Even with all of that, we target about 30% earnings conversion in fiscal 2021. And if I look at where those investments are going, it's about two thirds focused on selling expenses, so sales-related resources. Dave mentioned that we're targeting to grow faster and our incentive plans are aligned with that.

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The other third of our investments are really focused on R&D and on digital capabilities. And I would expect that you'll see a continued increase in R&D as percent of sales. It went from 2% to 2.2% and I think we'll be on our way to 2.4% or so this fiscal year in terms of investments. So we've got a few times we got the question so why would you accelerate the investments and the way we look at this is as follows. One, we can continue to deliver attractive incrementals at about 30% this year. Two, we've seen some of these investments already pay off. If I look at what we've seen in China, Dave mentioned earlier there are some areas where we believe we've seen some share gains. China is one of those areas where we made some investments where we've seen those returns. And I would say the other area is the aftermarket. You've heard us talk about increasing the attachment rate for aftermarket and services. We've seen that pick up in 2020. We have significant opportunities to continue to increase that with quite attractive financial return as a result of that. And so that's why we accelerated those investments. Selling expenses, some of them will take a quarter or several quarters before we can really see the impact of that. Other investments like, for example, R&D might take a little bit longer.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. Great. And when you think about the attachment rate, I mean, where are the key kind of buckets that you're making the investments? I could see putting more resources into the service network is being one but then also are there equipment modifications that you're investing into making it easier for Carrier to be the one that gets the service attachment?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Yeah. It's really a multifaceted playbook along the lines of what you were just describing. First is we need more feet on the street. So you saw us adding – last year, we added about 550 sales and sales support people. A big chunk of that is in the aftermarket to drive higher coverage and higher attachment rates. We then have this BluEdge multi-tiered offering so we can give the customers what they need, whether they want an elite offering or basic, we have an ability to real time price and give them a solution that's really customized to what they need.

And connectivity and digital is a big differentiator, a very small percentage of our chillers out there are actually connected. So one big focus we have this year is using our edge device and putting them on chillers. So one of the ways to unleash value is to connect the chiller and I use chillers kind of as an example of our entire portfolio. This applies to any other part of the portfolio but chillers is an example. Get the devices connected and then you can provide more value propositions to the customer whether it's remote diagnostics, prognostics, energy efficiency guarantees, or eco energy business. So it's really a multi-faceted playbook. The good news is it's not rocket science. I mean, we know the playbook. We know what works. We just got to deploy it as efficiently and quickly as possible.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

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Okay. Okay. That's helpful. And then thinking about inflation, it's really a lot of focus on input costs right now from investors, just metal [indiscernible] (31:56) all people, transportation and those things. I mean, how should we think of price cost in 2021? And how do you think that kind of plays out for Carriers you kind of walk through the year and what are some of the levers you can use to offset that?

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Patrick P. Goris
Senior Vice President & Chief Financial Officer, Carrier Global Corp.

A

Yeah, Tim. So, obviously, price is an important lever and we expect price to offset commodity inflation in 2021. We do, of course, block some of our purchases and we're well -- we've covered well over 75% of our requirements for aluminum, copper and steel for 2021. And so that together with the price increases we've announced early in the current quarter is certainly contributing to our expectation that we expect the net impact to us to be neutral for this year. Of course, this is not just for this year but also for next year sort of watching the movements closely. We're looking at what we lock in and when. And of course, we'll keep plenty of flexibility in terms of price increases to adjust and to ensure that we maintain neutral.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. That's helpful. And then I've got a question here from the audience. Could you just talk about your market position or market share in the applied market globally and how you can improve this over time?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Yeah, we had said that we would – our commitment was when Chris Nelson stood up at the New York Stock Exchange in February was he said that we would get to number one in global applied within five years. And what that really required us to do was to add about 50 bps a year. If we look at last year, it was probably closer to 30. So to get back on track, this year has to be closer to 70 bps. And a big piece of that is adding more salespeople which has – will have an impact. Two is new product introduction. We're introducing mag bearing chillers. We're looking at new products that will be coming out this year and then into next year as well, more energy efficient, more attractive overall product positioning.

And then connectivity is a major theme and then using the aftermarket to help drive some of the initial sales. So as we get more confidence that we're going to get what I'd like to see is 100% conversion, it gives us more confidence as we sell the initial chiller that there's going to be a lifecycle sale associated with it. So it's a journey. We have two peers that have higher share than us today but we're confident that within five years we will get to number one in the market.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. That's great. And then maybe just shifting over to the individual businesses, just on commercial HVAC, could you maybe talk about what your view for 2021 is just on the various pieces within commercial HVAC whether that's kind of your replacement demand, new construction and then maybe service? And there's been some questions about how equipment grows this year just given how commercial end markets still remain pretty weak. So I'm curious specifically what your outlook is for equipment growth in commercial.

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Sure. Maybe I'll start and you can add in. Look, for overall commercial HVAC, we have said it's going to be a low to mid-single digit and that does include some share gains in there. So we should see strong growth in our controls business at Automated Logic. The aftermarket is going to be up double digits this year. We expect that China will continue to be strong. There are certain verticals that have been strong like data centers, warehouses. Education should see a nice continued strength this year. Healthcare has been good and you supplement that

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with IAQ and healthy buildings, we mentioned that we have a couple hundred million dollar pipeline there which should give us a bit of tailwind as well.

But there's clearly some watch items. I'd like to see – you'd like to see ABI, the Architecture Billings Index north of 50, it's been below 50 since April of last year or so. I think December was around 42, 43. So that's clearly a watch item. North America is a watch item. We focused on some key campaigns there that we saw some success in. But North American commercial HVAC in the applied space is clearly a watch item, so a bit of a mixed bag. I think North America will be up slightly, Europe this year should be a mid-single digits and China should be up double digits.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. That's helpful.

Patrick P. Goris
Senior Vice President & Chief Financial Officer, Carrier Global Corp.

A

So aftermarket growing faster than the equipment and overall low single digits.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

And just to clarify, the aftermarket growing is positive for mix, right?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Yes.

Patrick P. Goris
Senior Vice President & Chief Financial Officer, Carrier Global Corp.

A

Yeah.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Okay. Okay. And then you mentioned, Dave, IAQ and that's obviously a really key topic among a lot of investors around HVAC and you've got some early progress here. How do we think about the near and kind of intermediate term opportunity? Because to me it looks like this is just really HVAC kind of gaining wallet share in building spend over time and I'm kind of curious how you would kind of frame IAQ maybe over a three to five-year time period.

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

I look at it as early phases because I think it's sustainable and transformational because what we're really doing is creating a new market that doesn't exist today. You don't – today, when you enter into an indoor air environment, you don't have the visibility that you would want or need in terms of key IAQ parameters. What is the amount of the ventilation that you're seeing in the building? What is the amount of particulate matter that you have in the indoor air space? And then if it's not at a, say, a platinum standard under the WELL definition or gold or even silver, what is it that the system can do to auto correct to improve it?

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So I think it's early phases. I look at last year, we introduced some new products, our OptiClean unit. We sold about 20,000 last year. We're targeting 35,000 for this year. So a new product, got a lot of traction. We saw demand for things like UV lights and bipolar ionization, in our F&S portfolio, a little bit around touchless access and thermal management – temperature screening when you come into a building. And more recently, on the home side, this is our first time with our Healthy Homes initiative that we've started selling Carrier home air purifiers. And I encourage you, Tim, to buy some for your friends and family, help out the quarter. But we've just started. You can go to carrier@home.com and buy them. We're selling them on Amazon and eBay and we're working with some of the big box retailers to start selling them there. We just started selling one-inch filters direct to consumers.

So I think it's early phases because we're selling some point solutions. And I think the bigger play is going to be our new digital solution that we're going to be calling Abound because it's abound with possibilities. It's Abound. It'll come out in April that Bobby George and the team have been leading, our Chief Digital Officer. I think it's going to be transformational. It will not only give visibility but tie into the control system. And then we're going to start supplementing that with a lot of partnerships we hope in key customers where we really start giving people confidence to re-enter indoor air environments. So early phases and I think it's here to stay.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. That's really helpful and encouraging. Maybe just on capital allocation, you've done a great job with the balance sheets since the spin. And it seems like you're broadening out the capital kind of allocation framework now. So, I guess maybe if you could just elaborate how investors should think about that for Carrier and can you just maybe remind us about longer term free cash flow as well?

Patrick P. Goris
Senior Vice President & Chief Financial Officer, Carrier Global Corp.

A

Yeah. So, Tim, you're right. Our balance sheet is much more solid than it was just a year ago. Net debt at the end of 2020 was about 2.8x EBITDA and it really means that we have much more flexibility to deploy capital in a more balanced way. You saw a couple of announcements. In December, we announced a 50% increase in the dividend. We really recently announced a $350 million share repurchase program and we also announced a $500 million debt reduction target we have for this year. So, much more balanced, but the priorities are clear. One, focus on accelerating organic growth, then focused on inorganic growth. You've heard us talk more about bolt-on M&As and what we're looking to do there. Then, the dividend then share repurchases and all of that of course within the overall structure of targeting in an investment grade credit rating.

In terms of maybe longer or expectation on the capital structure at the end of this year, I think I mentioned this on the earnings call, but we would expect to end up the year about 2.1x net debt to EBITDA and that assumes – that assumes new acquisitions or divestitures. Obviously, there may be some, but that's kind of what we have in mind absent some of the transactions.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay, okay. That's helpful. And how do you think about the portfolio today and then just maybe what you're – if you can kind of revisit your current thinking and maybe if you think about kind of the two or three kind of most critical decision points for kind of portfolio changes to Carrier, what was all of those really be?

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David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Well, we do have to take -- we said we would take a very clinical and dispassionate look at our current portfolio and figure out does it satisfy what we're looking for in a business? We want it to be high margin. We want it to ideally be able to generate recurring revenues. We want it to have a good growth profile, some differentiation. And parts of our portfolio don't fit those criteria. We have to decide are we going to invest in our own businesses to get them up to the kind of margins and the growth profile and the recurring revenue profile that we would expect of those, or are we better off selling parts of the portfolio letting others do that while we focus our resources on other things either organic or inorganic.

So, on the divestiture side, that's going to be something that we have and will continue to assess. And then if we decide that it is – it does makes sense to divest something then we'll have to decide what's the right timing to do that. On the acquisition side, we have our three pillars of growth. We do want to grow our core of course. So there's things that we can bolt on there. There's geographic areas we're underrepresented in. There's products – product extensions or maybe you could call them adjacencies, but really extensions beyond what we do today that are interesting and things that are going to drive aftermarket and digital offerings that complement our whole focus on healthy safe and sustainable buildings. So if it fits that strategically and it fits our financial criteria that Patrick's laid out then we're now fortunately positioned to lean into some M&A this year.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Looks great. And then maybe just one of the last questions I have is just maybe on the refrigeration market. Obviously, you're seeing a cyclical recovery in some of the truck/trailer business, but you're also seeing some of the benefits from vaccine distribution. So when you think about low teens organic growth for refrigeration 2021, how do you see that playing out between transport and commercial refrigeration?

David L. Gitlin
President, Chief Executive Officer & Director, Carrier Global Corp.

A

Well, commercial refrigeration is going to be high single digits. Transport is more in the high teen range. NATT when you think about what the order rates we're seeing in North America Truck/Trailer and the coverage we have for the year, we'd expect that 35%, 40% in that kind of range, it's consistent with what ACT has been publishing. Europe is more in the low teen range. Container, we have that in mid-single digits. There could be some upsides based on however orders play out but we'll see. And like on the vaccine side, that's most acute for our Sensitech business where we do cargo monitoring and that should be low double digits this year.

So we do see some margin expansion at 2021 considering that we have higher margins in transport than we do in our commercial refrigeration business. But our big focus is on data recurring revenues and we do want to see traction this year on our new AWS partnered Lynx platform.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Okay. Okay. Great. And I think we're about out of time. So please join me in thanking Carrier for being with us today and again running through their sustainability practices and their efforts there. Thanks, guys. Really appreciate you for joining us.

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David L. Gitlin

President, Chief Executive Officer & Director, Carrier Global Corp.

Thanks, Tim. Thanks for having us.

Patrick P. Goris

Senior Vice President & Chief Financial Officer, Carrier Global Corp.

Thank you. Thanks Tim.

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