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Carrier Global Corp. (CARR)

J.P. Morgan Industrials Conference

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CORPORATE PARTICIPANTS

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

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

OTHER PARTICIPANTS

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

All right. We're back. Second presentation of the day with Carrier. We have CEO, Dave Gitlin; CFO, Patrick Goris, and I think Sam's in the background there [indiscernible] (00:00:17) table. As usual, feel free to e-mail [ph] IV (00:00:23) or throw your questions in through the event website and we'll be sure to get those answered. We're going to launch right into the Q&A here. Guys, thanks for joining me.

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QUESTION AND ANSWER SECTION

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

We are going to kind of like – before we move forward, we're going to take a bit of a step back and maybe just a question for Patrick, but the – a bit surprising to us was the – not necessarily the revenue performance in the fourth quarter was very good, really the decremental margins were I think a little bit weaker than most people were expecting despite the fact that you guys had guided there. I think in general people thought you'd get better core leverage on the sales. Patrick, can you maybe kind of like just talk a little bit about what drove that, and in particular kind of the mix dynamics there to the extent there were any? And this would be excluding the investment you talked about. That's all visible and we understand all that stuff, but maybe kind of some of the mix impacts that you guys experienced.

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

A

Sure. Sure, Steve, and thank you for having us. So, a quick recap. Q4, as we mentioned on the call, pretty much as we expected. Currency was about $100 million tailwind for us versus what we expected, there's very little earnings conversion. Now, back to margins, as you mentioned, we had $75 million of investments in Q4 year-over-year. Most of that did hit our HVAC segment. Then, in addition to that, we have the – about $25 million of incremental public company costs similar to what we saw in Q2 and Q3. And then, we had about $50 million of one-time items. And those one-time items were about $20 million higher than what we had in our October guide and there were really two big items in that $50 million. One, that vendor contract renegotiation from the UTC days, we terminated that. We think we can do better. So, that was $30 million of that. And the remaining $20 million was legal and related items. So, that's kind of the margin perspective.

If I look at mix in the quarter, mix particularly within HVAC was a headwind and that really relates to commercial HVAC. So, commercial HVAC was down; but within commercial HVAC, equipment did actually well. So, equipment returned to growth. Aftermarket and service was still down year-over-year. Now, we built a backlog in aftermarket and services in commercial HVAC. So, that bodes well for future periods. But equipment being up, equipment having lower margins, and then equipment was up, all the growth in equipment was in Asia. North America equipment was still down year-over-year. And so, within HVAC, particularly commercial HVAC, that's the mix headwind that we referred to.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So, that would be kind of like applied versus unitary, if you will?

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

A

Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So, like, [ph] China (00:03:09) applied is definitely not as good as US unitary?

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

Correct. That's the way you can think about it, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay.

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

And then the good thing is, as I mentioned, backlog build on aftermarket and services and that bodes well, of ,course for future periods.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Is there – usually I would think that resi would be a pretty good mix. And you guys really did a good job in resi this year. Anything there regarding mix around more builders or different types of customers that may have not been as high margin as maybe your most rich type of sale?

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

Not in Q4. No.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay.

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

And so, clearly we saw the benefit of resi, attractive incremental margins, but all the, call it, margin headwinds that I talked to you about in Q4 kind of offset that.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. Moving forward, inching forward here into the first quarter, maybe this one is for Dave. What do you see in here insofar in kind of the major – in the major verticals?

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

Yeah. No surprises. Patrick had said that we'd be up double digits in the first quarter. We're tracking to that. Resi has come out of the gate strong. We had said that Q4 ended strong. We started the year with a very, very strong backlog. We said it was 3x over where it was at the same time last year. So, we came in with a good backlog. The strength in orders we saw in the fourth quarter have continued in January and February into early March. So, we're pleased with the order trends. So, resi feels strong.

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Commercial HVAC, the things that have been strong continue to be strong. Data centers, warehouses, education, healthcare, all those verticals continue to be positive and they're supplemented by our focus on healthy buildings indoor air quality. We talk about a couple hundred million dollar pipeline. So, we continue to lean into that area. We'll be coming out with a new digital offering here in April that I think will continue to catapult that as a market of – that's really here to stay. So, commercial sales on the HVAC side will be up. They have been up year-over-year in the quarter.

Refrigeration is tracking really where we thought, strong orders across the transport portfolio. That's in North American, European truck trailer. I would say a bit of the surprise has been the strength in container. Containers, I think it's an indication that markets are reopening and that trade has been strong. So, the container market for us has been very strong year-to-date. So, that's been positive.

F&S, we always thought would be – we'd see some nice growth this year. We thought it'd be a little bit back-end loaded because – partly because of the comparison, partly because of some of the industrial businesses, hospitality would pick up in the back half of the year. So, F&S is probably flattish in the quarter, but there's really nice strength in HVAC and refrigeration that get us to that double-digit growth in the first quarter.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

What are you seeing in terms of orders that's split between applied and unitary? I mean, the unitary bookings numbers from some have been pretty solid, but the revenues and the activity remain weak out of those – a bit of quotation activity out there, what are you seeing between those two types of business?

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

A

What's nice about the unitary business is we started with very low inventory in the channel. So, as we start to see orders pick up, we should be able to convert that quickly into strong movement from us into our distributors and then out into the field. So, I'd say it's – the light commercial orders are slightly down year-to-date, but that's an area that there is a lot of pent-up demand. 80% of that business, as you know Steve, is replacement. So, we do anticipate seeing some nice pickup there.

We've said the year is going to be up mid-single digits. I'm a bit optimistic. There could be some room on top of that, but as we start to see societies reopen, especially here, of course, in the United States. So, orders haven't been positive yet year-to-date, but you can see there's going to be – there's likely to be some upside to that.

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

A

That's specific to light commercial.

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

A

To light commercial.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. Got it. Specific to light commercial. Okay. Got it.

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

Yeah. That was all...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

When we think about the resi business, where will we be on channel inventory after the first quarter here? I mean, you guys are going to have a pretty big first quarter. The inventories in my view are kind of more in line-ish at the end of the year. I know one distributor that's – he hasn't necessarily taken the product, but he's secured his orders through August.

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

Correct.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

How do we stand on kind of that channel inventory at the end of entering kind of the selling season?

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

Well, we watch that, of course, as you know, very carefully. We thought – inventory levels were in balance as we came into the year, but orders have continued to be very strong. So, the good news is movement has been very strong. So, movement from our distributors to our dealers has been very, very solid. But despite that, the orders have been even a bit higher than the movement. So, we are seeing a little – a bit more inventory in the channel than we had at the start of the year, but it's something that we monitor, and we do work with our distributors to try to give them what they need when they need it to try to avoid having inventory levels get away from us.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right. So – I mean, this is – well, I mean, if you're in balance at the end of the fourth quarter and you grow very highly in the first, I mean, you will be pretty fully loaded heading into the year, or is there a – are those – is a lot of that going to build or is there some sort of other dynamic that's going on there because I don't think the end demand is growing strong double digits here in the first quarter? Maybe it is. I've seen Hardy up 7%, which is pretty solid, but not strong double digits.

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

Yeah. Like I said, movement's been very good. Right on the new construction side, you know that we're – we have very strong share on the new construction side which has continued to be very strong.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Yeah.

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

But despite the strong movement, with the kind of orders that we've been seeing, you would naturally see a pickup of inventory levels, not the kind that covers the entire year, but we're very well covered. We're more well covered for the second quarter than we normally would be.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right.

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

So, inventory levels have increased, but not to a point that's alarming. It's just to a point that we actually work distributor by distributor to say, look, here's your orders, here's what we have, and we try to manage it distributor-by-distributor because our number one priority is supporting our customers. And that's not something to say for a fact, it's reality. I think we picked up share last year in part because we could operationally perform and give the customers what they needed when they needed, and we're working that in the first quarter as well.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Yeah. For sure, you guys definitely took a little market share in 2020 which we'll get to in a second. Just to wrap kind of the first quarter, Patrick, I think there's some margin moving parts here with regards to Beijer in Q1 and there was a deferred [ph] cost factoring (00:10:30) or something in last year's quarter. Anything that stands out on the bridge that you'd want people to be aware of here on the quarter year-over-year margin-wise?

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

Steve, couple of things. So, on the earnings call, I mentioned that our Q1 conversion would be in the high teens.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Yeah.

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

That's reported conversion. So, we think that core conversion when I adjust for Beijer and currency will be obviously better than that in the 20s. With respect to Beijer, if I look at Beijer that's the investment, of course, that we divested last year, and so that – we won't have that in Q1. And then the deferred comp you mentioned to, it's really mark-to-market adjustments to our deferred comp. If I take those two items combined, that's $30 million of an impact year-over-year in Q1.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right.

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

A

That accounts for more than 5 points of conversion. Add to that that we expect currency to have the highest impact in Q1 and, you know, currency we gained on the top line, we gained some earnings but we don't have 30% conversion on currency. So, take that into account and that's why I say that Q1 conversion will be lighter compared to the other quarters of the year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it.

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

A

I'd say that's what we expect to play out. The only other thing I'd say is that we are seeing some higher logistics cost this quarter than we expected. And so, obviously, that – we were not the only ones, but clearly we're seeing that, a little bit more airfreight than we would have expected, but everything else pretty much playing up in line with what we expected.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Just production in resi being so strong, does that help you at all from a conversion perspective this quarter?

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

A

Oh, it always helps the plants a little bit if you load them more, but that might be at best timing within the year. And so, I don't think that would have a material impact. Of course, in this quarter as well because of some of the storms we had in Texas, we also have some inefficiencies associated with that. So, that might just be awash, Steve. So, I'm not sure there is a big – a tailwind for more production in Q1.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay.

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

A

We plan for a lot of production in Q1. So, I don't think that, that will be a, call it, variance.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Has your view on commodity cost and the impact changed at all over the last month and a half? Just remind us...

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

A

No. I...

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C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

...what you're assuming on costs.

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

A

No. I – it has not. We continue to expect price to offset commodity inflation in 2021. Well over 75% of aluminum, copper, steel requirements for the year are blocked. Price increases were announced. Through two months, our net price increase – net price realization, I should say, is in line with what we expected. And, of course, we target to do better than neutral. Our outlook for the year assumes neutral. And I'd say that, of course, we keep a very close eye on what's happening with commodity prices. We probably have more 2022 in mind now than just 2021 and we're also taking that into account as to what we do from a pricing perspective. This would not be the first time that we implement multiple price increases in one year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right. And I guess the – all right, the degree – David, degree of acceptance, is there a range by business? I mean, usually resi is higher than commercial and Fire & Security, I mean, is there a range of kind of acceptance here on these – or a degree of pricing upside by business?

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

A

Yeah, I think...

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

A

All right...

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

A

Go ahead. [indiscernible] (00:14:11). Yeah, I think your assessment is right. Actually, we're taking a very targeted and structured look at pricing across the portfolio. So, clearly, you've seen in the past where we've seen this kind of commodity headwind in resi, we have had to do multiple price increases and it has stuck. So, that's an area that we're certainly going to have to look at. And then within the F&S portfolio, it's such a broad portfolio that we look basically product-by-product to look at areas where it will most likely stick. And so, we're taking a pretty measured approach to price increases, but with the kind of commodity headwinds we're seeing, especially in copper and steel, we really have no choice but to look there.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right. And when it comes to those – the commodity headwinds, what's the number again that you're using for the – just commodity headwind [ph] for the year (00:15:04)?

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

A

So, Steve, on the call I mentioned that it was several tens of millions of dollars...

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C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah.

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

A

...for 2021 and that's after the impact from some of our blocking. So, if it weren't for that, it would be significantly higher than that.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So, [indiscernible] (00:15:20) hedging – the hedging?

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

A

Correct. Yeah. Correct, Steve. Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. Okay. When we think about these investments that you're making, Dave, maybe just can we split them between kind of product, geographic and then kind of services? And I guess you could put digital in there somewhere. I mean, where are – it is going to be a big year for investments, so how are those kind of broken apart? What's maybe biggest bucket, what's smallest bucket?

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

A

Well, the biggest bucket is selling right now. We were – we really did have to add to our sales force. We said that we'd add 500 sales and sales support people last year. We ended up adding a little over 550 and we continue to add to selling. So, we've said that we were doing $150 million of incremental investments this year. I would say about $100 million of that is just on selling and the rest is split between R&D and digital, probably $35 million or so R&D, $15 million digital.

So, we are – I could tell you that we're pleased with our R&D spend. We're seeing a lot of opportunities for differentiation across the portfolio. We're introducing new applied products. In the F&S, what's kind of nice is that you're dealing with, especially on the product side, high margin businesses that you can make relatively minor investments to pick up share that drops through at a high number. So, we're investing there, and of course, in refrigeration with a focus on more electric.

And then in digital, we're really going on offense on the digital side. Bobby George and the team there is really looking at some differentiated offerings. And we're excited about this new offering that we're going to be calling [ph] Abound (00:17:02) and that's going to be coming out in mid-April that really is going to I think really catapult this focus on healthy buildings and create a lot of customer pull for new IAQ type offerings.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

That is – and that's a commercial product, obviously, it sounds like?

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

A

Yes. Yeah, and it's going to be a...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah, sorry, go ahead.

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

A

No, it's going to be a commercial product – commercial offering. And the real intent is that it's an open architecture product that can interface with anyone's building management system where you have sensors throughout the building that can give you indications of various indoor air quality parameters, whether it's your ventilation levels, your CO2. It can look at particulate matter in the air and it's going to make that visible to tenants. So, before you go into a JPMorgan into the commercial office, you can look at your iPhone and see what are the levels of some of the key indoor air quality parameters. And then they can interface with the control systems of the building to correct any deficiencies of the IAQ level. So, if you see a buildup of CO2, you can increase ventilation. If you see an increase of particulate matter, you can bring in more outside air. So, we think it's going to really drive stickiness to the whole focus on healthy buildings and indoor air quality.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And I guess is there – is that a revenue opportunity on its own? I would assume this is kind of to pull in products, maybe even catalyze equipment replacements. What's kind of the business model behind this? And how do you look at sales and margins resulting from a product like this? You call it [ph] Abound (00:18:53)?

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

A

[ph] Abound (00:18:51), yes, because it's abound with possibilities and it is – it's both. There is going to be a subscription to it. So – but it's also, as you said, it's going to pull through product as well. So, what we're trying to be is the one-stop shop ecosystem for our customers for healthy, safe, and sustainable buildings. So, what – it's a part of that ecosystem creation. So, yes, there will be subscription type fees associated with it, but the bigger focus is to drive more long-term differentiated agreements that will tie into a service type agreement. We have these tiered offerings. It could help drive customers to some of our lead offerings where in the future state we want them to turn the keys over to us, let them worry about managing other parts of the building, and we can work with the customer to manage all facets of IAQ and the safety of the indoor air environment.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Do you feel as though you have a – is your entitlement to that as strong as others? You definitely have the – some equipment in there. Your control system is not necessarily spoken of in kind of the echelon of some of the traditional BMS players that are out there. Does that matter that you guys are coming up the curve more on the building management system versus these seemingly more established players, or am I wrong, do you guys have like a very competitive building management system that you think can go toe to toe with Metasys and some of these other ones: Honeywell and Schneider [ph] Electric (00:20:29) and the like because they've traditionally been more dominant in that space?

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

Yeah. I would say we actually designed the system recognizing the fact that we're not number one, two, or three in the building management system space. So, that's why we specifically designed it, so it was easy to interface with anyone's building management system. It's agnostic. It doesn't need to tie in with the Automated Logic control, that's our building management system offering that we have within Carrier. So, it doesn't need to tie in with that. It's open-architecture and interfaces with anyone's.

I will say though that we've made a lot of progress in our – and in our building management space with the ALC offering. That team has come a long way. It's a high margin product. We're seeing increases in share. We're investing a bit in the channel there to kind of continue to grow that. So we see a lot of opportunity there. We do think it's a very strategic area for us to try to keep focusing on growing. But we do think [ph] Abound (00:21:26) can help really bring us more into the building, recognizing the fact that we are [ph] not (00:21:32) one of the top three BMS players [indiscernible] (00:21:34).

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

How big is your BMS business? I mean, I always had it around $500 million, something like that. Is that...

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

Yeah. That's about right.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. Got it. Just tying a loose end on the margin bridge, how big is your G&A today? And what do you think the entitlement is? I mean, you guys have done such an unbelievable job on cost. Some of that is G&A, some of that is supply chain, how big is G&A kind of end to 2020? And how much more opportunity is there on that part?

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

Yeah, Steve. You can think of our G&A being a little over $1.7 billion.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay.

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

Carrier 700 actually is mostly savings on materials, some savings on our factory footprint. Within Carrier 700, there is about $100 million of G&A savings over three years. So now we're in year two. We see opportunity to do more than $100 million. And when I say this there is a lot of complexity within our business and we see, therefore, a lot of opportunity to simplify. We have over 500 different legal entities. We have lots of different ERP system and so we just started to implement automation moving work to hubs, lower cost locations, shared services. We just started on that journey. And we all know how powerful that can be and how much savings that can drive. So, we see opportunity to drive additional savings in G&A.

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C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. Got it. Okay. With the drop-off of investment in 2022, and continued execution on G&A, why can't incrementals in 2022 be like a lot higher than 30%?

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

A

Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Will it be more investment programs?

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

A

Well, our first focus, of course, is to deliver our 2021 commitments in the core conversion of about 30% as we said. You're right. We're anticipating savings of $150 million this year from the $300 million initial program that leaves another $50 million of investments in 2022. All else equal, that's what we'd expect to invest next year. If there are additional opportunities we see for higher return investments, we may move that $50 million up. If I look at Carrier 700 savings, we anticipate about $225 million in 2022. So all else equal, we would expect our conversion to be higher in 2022 than in 2021.

I'd just say two things, one, if we see additional opportunities for investments, we may increase them beyond $50 million. And then in 2022 and that's minor, but not all of our temporary cost reduction actions are coming back in 2021. So, there might be some additional headwind there in 2022, but I think that's in the few 10 millions of dollars, it's not going to offset the Carrier $225 million in 2022.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Dave, when it comes to really executing on the services strategy, nobody wants to own the building, given you have these, I would say, margin tailwinds in 2022 and you say you'd look to invest. Investing sometimes means, giving clients a bit of a better deal to kind of gain install base and expand that relationship and get your product specked in for the long-term. Is that something you consider an investment? I mean, actually, in aerospace that's kind of the way it works, right?

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

A

Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Is – I wouldn't say price, but is, I guess, discounts or pricing, is that considered an investment if you have some money to work with within the framework of strong incrementals?

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

We haven't booked – kept it that way. But from a business model perspective, if you look at our applied business, we are number three. We've committed to get to number one within five years. And you really have to look at it as a life cycle type business. So, as you know, the upfront sale of a chiller has lower margin than we see on the light commercial or on the residential side. But if you have confidence that you're going to convert that into long-term agreements, you can – it does help you increase your market share on the upfront sale, knowing that you're going to have confidence you're going to see the revenues over the life cycle. So, it is one of the reasons that we are really leaning into these tiered offerings and to driving our stickiness with these higher attachment rates, higher conversion rates, and overall coverage. So, it's not that we're going to be reducing price on the chillers, but it does help us look at the life cycle approach.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right. And how long are these contracts typically? I mean, you're looking at – I think JCI said last year upwards of three to five years, it used to be one to two and they turned, but is that kind of the length of the contracts that you're kind of thinking about now or is it even longer than that?

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

No, that's about right.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. Got it. Looking at resi, so great momentum from 2020 carried into 2021 here. You guys are definitely back on the horse when it comes to share in my view pretty clearly. How do we think about the cycle? This is going to be like – there's like eight seasons within the cycle here. I mean, it's first half, second half. And then in 2022, there's a potential for a pre-buy. How do we look at things through, I guess, the end of 2022 in your view, maybe take it by halves? I don't know.

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

Yes, I know you need a...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

What's your view on 2021 and 2022 and pre-buy I guess in 2022 in the cycle is I guess the question?

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

Yes. Well, if you look – if you put aside the really unprecedented lumpiness year-over-year compares within any particular quarter, if you look back at last year, we were up 10%. We think the market was up sort of high single-digit. So, as you said, we picked up some share. And 10%, a very solid year, but not completely unprecedented, clearly the second half for us was extremely strong, third quarter up close to 50%, 25% in the fourth quarter.

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This year we're going to be up north of 20% in the first half. It could be closer to 30% as we see how things shake out in the first half. And the second half is down 20%. So what we've said for 2021 is that if you put aside all the year-over-year compares quarter-to-quarter, when all is said and done this year for us – this year for us will be up low to mid-single-digits, which is sort of a typical year. So last year, a little bit higher than usual but about 10% this year low to mid.

We think next year we'll have to see how it plays out on the replacement side, where 25% of our business is new, about 75% is replacement. The new side continues to be very strong and we have very strong share there. So we're pleased with that. There should be a little bit of pre-buy ahead of the 2023 changes as we get into 2022. It's not going to be overwhelming, but you would expect some pre-buy in advance of the 2023 changes and then 2023, you start to see some of the benefit of the higher priced higher [ph] CR (00:28:54) units.

We should see a bit of tailwind from the healthy home opportunity. We've come out with some offerings there that should give us a little bit of tailwind as well. But we'll have to see how the cycle plays out in 2022-2023. But right now the signs are overall strong. Obviously very increased orders we saw at the end of last year that have continued. So as I said earlier we really are trying to take a measured approach to make sure the inventory levels don't get away from us in the channel.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

What's your percentage now of multi-family within that 25% of housing?

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

A

We don't really track that as much, Steve, because when you get into multi-family, it can cut across the portfolio. Some of it's – just some of – it could be a basic split unit all the way up to light commercial up into the applied space so it's not something we look as much at.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. Okay. And I guess pre-buy, you mentioned there will be some. I mean, do you think like 5%, 2%, 10%, what's your kind of initial guessing?

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

A

The word I would use is light pre-buy. I mean, it's – ...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah.

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

A

...I don't have – I wouldn't quantify it just yet. We'll have to see. And I think it will be a little bit situational dependent. But I think it will depend on the dynamics at the time, but I don't think it will be a hugely material number.

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C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

What's your strategy around the 2025 refrigerant changeover? I think you guys were all gearing up for kind of the 2023 in California. Now, it looks like it may be 2025 nationally. Correct me if I'm wrong. But is that something you have to kind of develop into a lot for today or is that already – or do you wait a couple of years to deal with that?

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

A

Yeah. We have been spooling up for a 2023 change there with CARR and it does appear to be 2025 as you said. So, that does give us a bit more breathing room on that. We've clearly been working on an A2L solution in the R-454B. We still do experiment off to the side with our compressor supplier and our refrigerant supplier on an A1 possibility. So, there are some issues we're working through there, but our primary path is the A2L and we'll continue to experiment to see if we can make an A1 solution work.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And you don't need to switch compressor suppliers for this?

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

A

No.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. Got it. On the commercial side, how do you guys define attachment rate again? Maybe just walk through how you define it, where you expect it to go and then what kind of growth that ultimately drives?

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

A

Yeah, Steve, we've been looking at two different terminologies attachment rate and overall coverage. Attachment rate, we defined as after we sell the initial chiller, are we signing a long-term agreement after the warranty period expires? And that went from 20% to 30% last year. Now if you were to define it as do we have aftermarket revenues after we sell an initial chiller, of course, it'd be 100% because we sell parts and we do sell discrete things.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right.

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

A

So we actually take a strict definition that we expect in LTA coming off the warranty. And that's how we're defining attachment rate. And we do see continued momentum on that 30% as we get into this year and beyond. My goal would be 100%. As you said before on aerospace, that's the expectation is that you sell something on the new OEM side you get some kind of LTA that comes out of it. We're not going to get to 100% overnight, but that's the thought process that we have internally.

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Our bigger focus is overall coverage. If you look at the amount of chillers that we have out there in the marketplace, less than – really well less than 25% of those are under some kind of LTA. So to really move the needle on our aftermarket revenues, what we want to do is increase the overall coverage. Those are our units, where the OEM though should be under some form of LTA with us. We can work with other partners either in the channel or outside the channel, third-party providers, they can do some of the wrench turning or other things in situ, but we should be using our digital tools to differentiate our offering as the OEM to provide an LTA to the customer.

We've targeted internally and we've said externally that we're targeting 10,000 additional units this year. That is not – that's the same number we're tracking to internally. So it was a stretch, we said internally we put the number out there publicly because we expect to drive ourselves to 10,000 additional units of coverage this year. It's not going to be easy, but it's what we're driving.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And so, your installed base is on – so, the 10,000 units, what does that apply? What percentage of your installed base is that?

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

It's very – well, we have over 300,000 units out there. We haven't been specific on the number of units, but it really does – if we do 10,000 a year, that really can start to move the needle over time.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And that's applied or that's unitary as well?

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

That's applied.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Yeah. Okay. Yeah. That makes sense. Sorry. Stupid question.

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

No.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

On the applied side, what product are you kind of most excited about? My biggest disappointment is not being able to go to the AHR Expo this year. What new product are you most kind of excited about on the applied side?

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

A

Really, on the applied side, we have a next-gen air-cooled low-GWP chiller. It's both a chiller and a heat pump in the EU. So, it's using an R-32 low-GWP refrigerant. On the heat pump side, which you know is a very attractive market in Europe, so we really want to lean into heat pumps in Europe, but it really covers the span up to 500 kilowatts and then, chillers covers a very broad range from, say, 60 kilowatts all the way up to 950. But air-cooled screw low-GWP, we think it will have best-in-class efficiency, which will be very critical, because we're really leaning into sustainability. It's very thematic across Carrier. So, we continue to focus on that. It's ecodesign compliance. So, that's one.

We have others, Steve, that will be coming out, a mag bearing offer that will come out soon as well. So, we are investing – part of that R&D portfolio that I mentioned is going to that chiller space for a couple of these new offerings.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah. That's – that the Europe opportunity is – I mean it was stagnant for years. It seems like everybody is very bold up on what's happening over there. We have a question on the line here. Watsco announced the TEC acquisition this morning, Carrier Enterprises. Can you just talk a little bit about what that is, what the revenue base is for that one and what's going on there?

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

A

We're excited about it. I would tell you that we worked very closely with Al and the Watsco team to really build that relationship. And I think it's been a very positive win-win for both of us. We're both focused on growth. They've made a bunch of very positive changes that I think contributed to the share gains we saw last year. They were very direct rightfully so that we need to make some changes, whether it was a branding strategy, a product strategy and maybe on the lower [ph] CR (00:36:28) side. So, we had very direct discussions with each other on things we both needed to improve that would benefit both of us. And we both made the changes and we've seen the benefit from that.

And part of Watsco's business model and overall Carrier Enterprises is to look at some other acquisitions. TEC is a phenomenal distributor. Skip Mungo and the team in the Chicago area are really best-in-class.

So we work with the Watsco team. Watsco has done a nice job managing that acquisition into the portfolio. It'll be consistent with CE slightly. There's some slight nuances to it, but it'll be something that we're very, very excited about. And we're so glad that Skip will stay part of it. And part of the Watsco approach is to let these distributors who have built these phenomenal franchises over many decades multi-generations in many cases, let them go operate their business in a very effective way. We have great share in that area and we're excited to work with, Al and Skip on that integration.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

You guys had also mentioned recently that you were kind of more seriously evaluating your VRF strategy at least enhancing it in some way. I mean, Toshiba has been a partner for a long time. Anything going on there that's a bit of a change in direction?

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

A

Well, look, we are very interested in expanding our VRF presence. You know it's about the same size as the chiller space and it wasn't that long ago, we're half the size. So the CAGR of the VRF space is growing exponentially higher than the base chiller space. We know that you have a mix in the space where there's some players in the VRF space that actually have very good margins. So we've looked at how do you position yourself to grow and to grow with the kind of margin drop through that we expect.

So we're looking at various strategies. We have an organic strategy that we continue to lean into. But the reality is, we don't design the product. We don't manufacture the product. So we're largely part of a distribution channel. And we want to become more of a player in the base design and base production of the product. So it's not – if there were an easy solution, we would have done it 5 or 10 years ago. So we're looking at various place we can make there to get into the game in a more effective way and then expand it over time. We have very constructive discussions with Toshiba. They've been a very strong partner for decades and we work with Midea as well. We've – we talk to them in very constructive ways and we look at other alternatives as well to become a bigger player in VRF.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And this should be on the commercial front because I know there's a residential side of this as well? That's actually moving up from kind of the appliance category, if you will, would this be mostly on commercial?

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

A

It is. But like you've said, it will be interesting to see where that whole space go when you get into VRF and ductless. Is there an ultimate play that where it becomes a bigger technology solution for the residential space? Maybe. So that's why our focus is becoming a market leader in that space over time. It's not going to – I mean when you're about 1% of the market, you can't start thinking too much about becoming market leaders. But the way we think of ourselves as we have to become technology leaders, we have to have production capabilities, we have to have the channel capabilities and then we can then drive the right kind of growth and profitable growth over time. The truth is we need to get in. We need to get in the game in an effective way and that's what we're looking at.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

But that seemingly requires like either buying in part of the JV or doing something more strategic, right? I mean it's not – you're not just going to come out with a new carrier system on your own. Seems like your – you need to do something strategic there to kind of give it a shot in the arm.

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

A

Yes. I think that when we talked about bolt-on M&A, what we've said is that we want to focus on healthy safe and sustainable building cold chain solutions and we have this three-pronged approach to growth, growing the core, product adjacencies and VRF clearly fits in that second category of growth. So that would be one that would – you would naturally consider for bolt-on M&A. And then the third is services and digital. So, we'll continue to work on our organic strategy, but that would lend itself to an organic as well.

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C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Got it. Guys, I really appreciate. I think we're out of time here. I could talk about HVAC all day and all night but maybe we'll be able to do that over a beer at some point in person. But I really appreciate your time with us. I hope you enjoyed the rest of the day and best of luck this selling season and to the rest of the year. We'll talk in April.

David L. Gitlin

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

Thank you, Steve.

Patrick P. Goris

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

Thank you, Steve, Stay safe. Take care.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Appreciate it.

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