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Carrier Global Corp. (CARR)

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Joe Ritchie
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MANAGEMENT DISCUSSION SECTION

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

There they are. So, you guys will just have to unmute. But we're excited to just resume the afternoon sessions. So, with us today, we have we have several members of the Carrier team. We've got the Chairman and CEO, Dave Gitlin. We've got the CFO, Patrick Goris. And we also have Investor Relations, Sam Pearlstein.

Guys, thank you so much for being with us today. I will tell you, I think you guys are muted right now. So, maybe to just take it off, why don't we just start. Dave, it's been over a year since you guys went public. Maybe just talk a little bit about some of the benefits you're seeing running Carrier as an independent company and from being able to allocate resources in a more focused way.

[Technical Difficulty] (00:01:03-00:01:42)

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

So, listen. Thanks for having us. I think the question really was around Carrier since spin. And what I can tell you is that Carrier today – and Joe, you know us. It's a completely different company than we were just a year ago. We have a new culture called the Carrier Way, which is not – it's not words on a piece of paper. It's real. I mean, we're focused on agility and growth and customer-focused empowerment, killing bureaucracy.

We just did a poll survey. Our scores went from 70 just over a year ago to 75 today. We have a new operating system with Carrier Excellence, a very focused business, focused on really two ecosystems, healthy, safe, and sustainable buildings, and cold chain solutions. And all of our investment and portfolio decisions are aligned with our priorities as a standalone Carrier.

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So, look, it's a marathon, not a sprint. But the teams come out of the gates with great energy and focus. And we are – I could tell you that for me, personally, I have never been more energized about the amount of value that we can create.

QUESTION AND ANSWER SECTION

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Well, Dave, that's awesome to hear. And look, maybe just kind of jumping off there, some of the changes that have been made more recently, I think in the proxy statement about a month ago, you added sales to the compensation structure. And I know that you've added about 600 salespeople over the last nine months. Just talk about the traction that you're getting there and also kind of like what you're hoping to accomplish with the change to the compensation plan.

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

A

Sure. Let me start with compensation plan and then just a mention on the salespeople. We actually went to great lengths to look at every aspect of how we compensate and incentivize our executives and then our entire population. And we're really focused on delivering long-term value for our shareholders through three things: growing revenues, delivering strong earnings conversion, and cash flow. So, our new IC plan does reflect that objective.

We did add sales because sales are not just an output of market conditions. You do drive sales. So, if you look at our IC today, it's 40% sales, 40% earnings, 20% cash. And we also really reassessed our long-term incentive program which is 50% options, 50% performance base. So, our compensation committee and our board went to great lengths to tie management incentives to shareholder value and shareholder returns. And I'm very pleased with the formulas and the incentives that we've come up with.

And then on the salespeople, we've added 600 sales, sales support people over the last nine months. We were very targeted in where we've added them. And where we've added them, we've seen traction. We were focused on China, very specific regions within China, and our China sales were up 20%, continue to grow very well. Very focused on aftermarket growth and we've targeted ourselves to be up double digits in aftermarket this year. We're on track to do that. First quarter was quite strong.

So, where we've added the sales and sales support people, we're seeing traction. It's usually a two- to three-quarter payback to get the breakeven on the sales folks. You see that profitable sales growth over the first couple of years. But we're very pleased with how the salespeople that we've added are adding to the top and bottom line.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. That's awesome to hear, Dave. But maybe following on that sales comment and just thinking about labor more generally. I know that mentioned at some – where you added was in Asia and that you're getting the growth there. I guess are you having any issues with finding labor at this point and helping feed that sales pipeline that you're trying to grow?

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

A

We are. We've been having acute challenges on the labor sides in particularly how markets where it's very competitive for talent. So, if you take Collierville, Tennessee, for example, we're in the process of hiring 300, 400, 500 people there to really keep up with the demand that we've been seeing in our residential business. So that's where we do our residential splits. And I can tell you that we're having to go to great lengths to find and attract and retain talent in some of these key markets.

So we've been fine in places like Monterrey where – Mexico, where we have over 5,000 people. Indianapolis has been kind of tight. We still need to hire there a bit. Collierville is very acute. We are in the market for hiring digital engineering talent as well. So the labor market is particularly tight in certain parts of the country and certain parts of the world right now.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Got it. That makes a ton of sense. You mentioned digital there. You recently launched Abound. This is your digital healthy buildings offering. Just curious, maybe talk to us a little bit about how it works. How is it different from other digital offerings in your portfolio?

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

A

Well, we think it's unique in our portfolio. We think it's a unique offering in the marketplace. We created kind of a skunkworks project about eight months ago. We put a dedicated group of people together to really create a digital enabler to give people confidence to re-enter crowded indoor environments. And it's not only in IAQ, but we've also been adding sustainability features to it.

So it's a SaaS-based, cloud-based platform, and it really acts as an intelligence layer interfaced just with anyone's building management system, so not only with our own ALC, but it can work with third party building management systems. And it add – it gathers IAQ data from around the building and it can be present it in a very smart, simple interface. So it identifies and then helps a building manager or the underlying systems address any anomalies.

And what's important is, as I mentioned, it is open architecture. And it's an interface layer that we believe is really kind of cutting edge. And we just introduced our first version of it. There will be follow-on versions of it, of course, as we continue to add features to it. But we already have a deal with the Atlanta Braves as they start to welcome fans back to Truist Park.

We've talked about the healthy building market being a $9 billion to $10 billion-type opportunity. And I believe Abound is going to be a key, key enabler to go really addressing some of that IAQ and healthy building opportunity.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Now, that's awesome, and I'm sure we're going to get into that opportunity in just a minute. But maybe it's nice to see Patrick again. And it's been six months since he joined Carrier. I just love to hear kind of like your initial impressions on the company, where it's going, and any thoughts you have on your first six months.

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

A

Yeah. Joe, thank you for having us and good to see you again. Obviously, I'm very excited to be here. It's not every day that you can join a hundred-year-old startup company. It's an attractive industry. We're in a great financial and market position and I see tremendous potential throughout the company.

You heard Dave talked a little bit about the opportunities we see. But from an outsider in, I see tremendous opportunities to grow the top line, to improve our margins, to improve our free cash flow conversion opportunities. And it's a great place to be. And when you hear the priorities that we've been talking about, growing aftermarket, the opportunity in digital, and then anything we do in terms of or can do in terms of simplifying our internal organization, driving out costs, we have a lot of levers in front of us that we can use to drive a lot of value for shareowners.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Maybe just picking on one of those levers then, Patrick, and talking about the aftermarket opportunity, and Dave your comments around driving double-digit growth there this year, I know that you've talked historically about your aftermarket, your attachment rates being well below 25%. Maybe just talk to us about the progress that you're making there and what the opportunity is for you there.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

A

Well, we actually started last year with attachment rates at 20%; we closed the year at 30%. That will continue to improve. But if you kind of step back and look at our whole journey in the aftermarket we're actually in the midst of our strat review season. We're going through our strategy reviews. We had our aftermarket strat review with Ajay Agrawal and his team yesterday and the P&Ls.

And it's amazing where we are today where we were just a year ago. There's an entire playbook that that team has put in place to really grow aftermarkets at that double-digit rate, has to do with how we deal with our suppliers and our customers and digitally enabled BluEdge type offerings. I got to tell you, it's so encouraging to see the progress in the team, the processes, the playbook.

Our focus on the chillers is – we've shifted in addition to driving attachment rates we want to drive total coverage because that's really going to move the needle. And we said that we started this year with 50,000 of our chillers under some form of long-term agreement. We're going to end this year at 60,000. We'll keep driving that up. But that's just an example of what we're doing across the entire portfolio.

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

A

Yeah, we see similar opportunities in refrigeration and fire and security. So the aftermarket is across the portfolio, and it can be really meaningful from a revenue and a profitability point of view. And so you may have heard us say, but over the life cycle of a product we think the aftermarket revenue is over 5x the original equipment sale. Now that's not evenly split over the life of the product but it's meaningful. And of course on average it has more attractive margins than the original equipment sale.

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Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. That makes it – that makes a ton of sense. Dave, I want to go back to that comment around like your chillers under contract this year, getting it to 60K. I mean – and so how is that actually working? Like how are you able to then really kind of drive increased penetration? Is it just basic blocking and tackling? And then and then how do we think about the margins of those chillers being under contract and whether they are – the margins on these contracts are as good as you would get potentially in like a spot market?

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

A

Yes. The answer to your latter question is yes. The margins are obviously or certainly better than the OE and they're consistent and in many cases better than we would get kind of on a time and material type basis.

What we're really focused on is as the OEM, we have capabilities to add more value to our customers than some of the disparate providers. So we understand the equipment. We've hired and we continue to add highly trained technicians. We have the parts availability so we can have the parts located globally where we need the parts when customers need them. We have the global footprint. So we can really – and we also, because we understand as the OEM the underlying physics of the equipment, we can leverage our knowledge of the technology.

So the 10,000 increase is not only driven by improving the overall attachment rates but it's adding things that are in the existing install base to an existing contract. We're increasing our renewal rates. These tiered offerings that we call BluEdge, what we want to do is drive our – really encourage our customers to go to our high-end elite offerings which are really digitally enabled.

Now you're starting to get into things like energy efficiency guarantees, remote diagnostics, prognostics before the equipment fails. It's a very specific playbook that once encourage customers to go to that elite offerings it's best for the customer, and quite honestly it's best for us.

So, pleased with the traction. And like Patrick just said, it's good on the financials, but it's also being applied across the portfolio.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. That's awesome to hear, Dave. We'll continue this conversation on [ph] applied (00:13:57) in a second. But I'm getting a question in already from the audience specifically around price increases. So the question is, can you talk a little bit about price increases introduced year to-date especially in light of aluminum, copper and steel inflation taking place today? What would have to be realized price increases in your products to keep you in the price/cost balance neutral for the – through the end of the year?

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

A

Yeah. Joe, I'll take this one. So on the February call, we mentioned that the headwind from input costs was in the tens of millions of dollars and that price would offset those cost increases. And think of the tens of millions of dollars as being a little less than $50 million. Now, since February, we're seeing a further significant increase in input costs. Some of that is, of course, aluminum, copper, and steel. But that was already 75% blocked, and today

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we're about 85%, 90% blocked. So the biggest headwinds now are not really from commodities, but from the component suppliers and freight.

The incremental headwinds that we now see are about $70 million, 7-0, million on top of what we initially estimated for the year. And so our current guidance includes additional pricing actions. We've announced price increases in our HVAC business, up to 7% effective in June. We've announced second price increases in truck and trailer. And so our current guidance assumes that we realize another $70 million in price for the balance of the year and our price/cost assumes to be neutral for the full year.

We're watching this really closely, of course, for several reasons. One, of course, there is a timing of the input costs and then when we get the price. Q2, as we said on last earnings call, might be a little negative because the timing of those two. But the other reason why we're watching this closely is, of course, we're looking ahead into 2022. We're benefiting, of course, from some of the hedges we have in place. I just mentioned that. Those don't run forever and that's why we're already looking now at additional pricing actions to offset inflation impacting us next year. And in addition to that, we're always looking at what we can do from a cost side. And so internally, we have picked up activity around what can we do to further reduce our costs. Of course, that's part of the Carrier 700, but what else can we do to drive down costs to help offset any headwinds there.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. That's helpful, Patrick. And I mean, I guess, the following question for that is are you getting any pushback either from your distributors or in the commercial sized refrigeration channel in being able to put through some of these price increases?

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

A

Look, I mean, I think that there's a broad understanding that there's inflationary pressures across the board. So, no one loves a price increase on the customer side, but I think people generally understand it.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. No, that's fair. Maybe shifting gears back into that, that applied discussion that we were having. I think you guys have talked about a longer-term goal of just becoming a market leader and applied, want to gain share. I think you've talked about 50 basis points of share gains each year. I guess, when you think about the progress that you made in 2020 and what you're seeing here today, just talk about some of the drivers that are going to help you get there. I'm sure part of it is the attachment rates, part of it is digital. But any thoughts around that, Dave?

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

A

It's exactly that. It's the attachment rate. It's new digital offerings. We've added salespeople. We've invested in the product line. So, we have new technologies that are coming out both in Europe and globally. So, I think it's not a terribly novel playbook, but it's a playbook that we're investing in and committed to. And we saw nice share gains especially in the second half of last year. That momentum's continued through the first four months of this year. I was particularly pleased with China. We saw nice share gains in China last year. That's continued this year.

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North America, we'll start to see pick up. What's encouraging about North America is ABI. I'm sure you know better than anyone, Joe, but it was up – it was at 53% in February, 55% in March. We'll see what April says in the next couple days. But a nice leading indicator that construction activity is going to start to pick up as we get into the second half. And then you have all the opportunities around education here in the United States where, of course, about $130 billion of the $1.9 trillion was dedicated towards education. Another $100 billion associated with the new Jobs Plan, if that does go through on the Infrastructure bill. So there's just a lot of positive signs out there that construction activity is going to pick up, and we're focused on leaning into that opportunity.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Now, that's – that all sounds really good, Dave. I guess maybe just following on that question on the ABI, your light commercial business was, I think, up 10% or greater than 10% this quarter. But you guys talked about field inventories being down 30%. So, I mean, that's an incredible statistic. I mean, are we at the start potentially of a restock cycle on the light commercial side as well?

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

A

I believe so. I mean, there's a lot of positive signs on the light commercial side. I would expect Q2 to be strong, obviously, coming off easy compares from Q2 of last year. But you have a nice mix here where backlog is up very, very strong coming out of Q1. It's up 100%, again an easy compare.

But backlog is strong. Field inventory is down. They were down, I think, about 35%. So you are looking at a real potential for restocking with these low inventory levels. And then you have some pent-up demand in some of these key verticals, restaurants, retails, schools. So we've said that for the full year we would expect light commercial to be up around 10%. Previously, we thought it would be mid-single digits. So that contributed to the guidance increase that we had at the end of 1Q. And light commercial is feeling very positive right now.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Great. Shifting gears, maybe going back to like IAQ and stimulus, like can you just talk about the conversations you're having today, maybe around like the stimulus measures? It seems early, but some of your peers are talking about good growth rates this past quarter. I'm just curious what are you seeing so far on those conversations, maybe specifically on the K-12 opportunity?

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

A

Well, look, we have that $130 billion that was part of the $1.9 trillion, and then you have this additional $100 billion. But we're seeing a lot of interest, if you look at the fact that the GAO said that 40% of the schools, the K-12 schools out there have insufficient HVAC systems today.

So you have a combination where you had traditionally underfunded school districts now with access to funding and insufficient HVAC systems and a critical need with the focus on ventilation and sustainability. You have a really nice combination for growth in this space. And what we focused on is having executable offerings that people can latch on to relatively quickly.

So our OptiClean unit, we've seen very strong interest there. We have controls upgrades. So it's not replacing the entire chiller, for example, in some of these. It's really targeted hit-type offerings. We've added salespeople

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focused in this area. We've done seminars, really focused in this K-12 specific area where people have signed in for. We have more various IAQ type offerings, real-time monitoring with Abound. So the interest level has picked up significantly. What we have to do this quarter next, is really convert the interest, the discussions, go tap into the funding available and start executing on some of the offerings that we have. There's sometimes a lag there, but we do see a lot of interest for sure.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

That make sense. I'm smiling because one of my colleagues sat through one of your seminars I think last week on K-12.

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

Nice. I hope he or she enjoyed it. Yeah.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

He did. He did. I'm looking at his notes right now. You did call out like the Healthy Building pipeline. Yeah, I think you called out $500 million this quarter. It was up nicely, and some $200 million in the last quarter. What do you ultimately think this opportunity can be? I mean, can this add a couple of points of growth to your top line?

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

Yeah. We put it in that 1% to 2% range per year. I think for us, we do think it's something that will stand the test of time because there's a clear need. You can see the anxiety. As people start to go back into crowded indoor spaces, they want some confidence that it's safe for them to do so. So before you make that restaurant reservation or before you go back into a crowded commercial office building, people want to be able to look up and see that the indoor air environment is safe. So we're working with a school outside of Atlanta in the Cherokee School District where you go into the library and you can see that it is a good indoor air environment. And that gives parents, that gives kids confidence to be in crowded indoor environments.

So Abound is a key enabler. Our product offerings like OptiClean are important. And we always try to use healthy and sustainable in the same sentence, because it's going to be both. People want healthy indoor environments. But you can't open the paper, you can't turn on the news without more focus on sustainability. So all of our offerings are usually combining those two things, a healthy offering with sustainability.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. That makes sense. Maybe shifting gears, Dave, and talking about resi for a little bit. Clearly, last three quarters your top line growth has been superb, right? And we know some of that is selling through distribution and restock. I guess maybe walk us through some of the work you've done just in this vertical to help support some of this strong growth. And then also like how long does the restock cycle last in resi HVAC back in your view?

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

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Well, look, the encouraging thing as you said, Joe, is we're coming off three really good quarters of growth. And the kind of movement and growth that we've seen has continued into April. So – and I think it's due to a bunch of factors. Operationally, we performed well. I will tell you we have not been flawless. We've had our issues both in our factories and in our supply chain. But I think if you – all of us have had our issues and I think we've had a lot of availability when others didn't, and I think that's helped us.

We were very deliberate in attacking some of the underserved markets, having the right brands, the right products in the right locations. We partnered with our distributors in a way that I think we haven't in many, many years and our distributors have really stepped up in a profound way. And it's been a great partnership with them.

New construction as you know continues to be strong, up 11%, 12% this year coming off 5% last year. And we're overweighted there versus some of our peers in new construction. And then we've gone out of our way to convert dealers to Carrier and our Carrier brands and that's proven to be sticky in a number of cases.

So, look, we came out of the quarter with inventory levels up year-over-year at 30% or so. But we've anticipated that when we get to the end of 2Q, our inventory levels would only be up about 10%, 15% over Q2 of 2019, which is a good barometer. And if we look at the movement that we had in April it would support that kind of indication.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Fair enough, now, and all great to hear. We're getting a question in from the audience, specifically around some of the growth you just talked about in China. And so the specific question is, look, you've got some pretty strong HVAC players in China as well like Gree, Midea, Haier. Like what specific segments of the market are you notably gaining traction in?

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

A

I would say across our portfolio in China – and I'm telling you that if you look at our commercial refrigeration business, our transport refrigeration business, fire and security like our GST business in China has performed extremely well over there. And then of course, really across the board in HVAC chillers, the big thing that we announced last quarter was our acquisition of Chigo that we'll close on later this month. And that really is our first, I would say a true entree into having product and technology capability in the international light commercial and the VRF space.

So that was a very, very important first step for us in – not only in China but in the overall VRF space. So I will tell you that I'm really, really proud of the China team across the portfolio.

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

A

I would also say, Dave, I think we expanded our presence in the Tier 2 cities, if this helps.

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

A

Yeah. That's important to.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

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Yeah. That's both great. I'm getting now, I'm getting like an influx of questions from the audience. So the next one for you guys, has the past year on its own or COVID in general changed your view on fire and security as a core?

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

A

Well, let me segment that question. When you think about our fire and security business, there's really two aspects to it. There's a products business and there's a field and installation business that is under the brand of Chubb. I will tell you that on the former, if you look at the capabilities we have where we can combine some of our really leading cutting-edge products business in F&S with our HVAC business, and you do that under the – either building management system or Abound, I believe we have some really differentiated offerings that really leverage those two businesses.

If you take our security business, LenelS2, knowing where people are in the building can really tie in with a very smart HVAC system because if everyone's gathering for a town hall in a conference room, you can either pre-ventilate or auto ventilate that system. So knowing where people are ties in HVAC, the fire system ties in with HVAC and then getting into smart buildings and the building of the future, I think our portfolio can be very, very differentiating.

Look, the Chubb business is an agnostic business. And it doesn't pull through product. It's lower margin. And what we've been very clear on, on the Chubb business is that our focus is on improving the business, improving our branch performance, improving the overall margins of the business, growing the business profitably, improving the cash performance. And we'll get to a point where we decide, look, we're happy with the trajectory we're on and we'll keep growing and improving it or we will decide to sell it. It really – that's like every other part of our portfolio that we'll continue to assess. But right now, we're heads down, really continuing to improve the base business.

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

A

And then the business has – is doing better as you heard on the last earnings call. Record backlogs for installations and sort of clearly, there is an improving trend there.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. So, it's interesting that we've gone this long. And we haven't asked about Carrier 700. So, next line of questioning started out as Carrier 600. Look, it's just based on our prior conversations. It seems like you're not planning to stop at 700. So, where – maybe talk to us about the progress that you expect to make this year and then how you're thinking about it beyond this year.

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

A

Yeah, Joe. Carrier 700, so the program is to drive $700 million in savings over 2020 to 2022. Last year, we did about $250 million. This year, our target is $225 million. Obviously with the headwinds that we've seen on input costs because this is a net number, getting to $225 million will be more of a challenge. We had a little bit of a contingency there, but even then we think that we may end up a little bit close to $200 million this year. That implies another $225 million next year.

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A lot of this is supply chain focus. Next year, there will be a larger component related to our factory productivity, as well as savings in G&A. For example, the real [indiscernible] (00:31:07) with some of the indirect savings haven't really kicked in yet. And also some of the inefficiencies that we've seen in our plants related to COVID, again, have not gone completely away.

And so, a lot of focus on achieving our objectives for this year. Again, another $225 million next year. And after that, I don't know what name we'll come up with but the focus on reducing cost, driving efficiencies will not go away.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Got it. That's helpful. We're getting a couple more questions from the audience. So, your next one, just you talked about labor earlier. Any comments on labor inflation and headwinds associated with that for 2021?

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

A

Well, look, I think our focus right now is hiring the right talent in the right skills and the right locations, and there's a couple of acute challenges. The bigger headwind I worry about next year is not labor inflation. It's really more around commodity inflation. We watch those commodities every day. We're trying to be as proactive as we can to try to manage as early as we can some of the hedging around 2022 headwinds around steel, copper, aluminum as you asked earlier. So, those keep me up at night more than the labor inflation headwinds. But I do – we are very, very focused on adding a significant amount of talent to keep supporting our customers and we've been challenged as I mentioned in a few key areas there.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Now, that's helpful. And I guess maybe the question that I want to ask you, actually, just more broadly around the M&A and the divestitures, you have done quite a bit even just in the last 12 months in simplifying your business. How are you thinking about the optionality whether that's with the JVs? I know you touched on Chubb already. But how are you thinking about the optionality in the portfolio today?

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

A

Well, let me start with the JVs and then talk more broadly. Look, one of the big themes at Carrier is simplification and focus. And as you know, we started with 40 minority JVs, and some of which were we're not strategic, didn't move the needle. You saw what of course we did with Bear last year.

And when I – I've said that we were going to get the 32, 40 down to 32 by the end of this year – and I would tell you, I don't think any of those, the remaining ones are material. They're not going to materially impact equity income as best we could tell. But it's a lot around simplification. You have JVs and you have some of your key managers on boards. They're distracted with things that really don't move the needle for the business.

So, we've already exited 40. We have another three in process. There's a couple others that we're working on as well. So that's part of simplification focus. And that's true. As we think about the portfolio, one of the really energized – many energizing things about Carrier is that we do have a lot of portfolio optionality. There's things in the portfolio that are clearly lower margin, less differentiated than other parts of the portfolio, and we need to take

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a very sober and clinical look at those, and decide not only whether we should sell them but what's the right timing to do it and what's the right way. Do we keep an interest? Do we sell all of it?

So, we're going through that exercise with all aspects of our existing portfolio. And then, we know there's a lot of bolt-ons out there that would be really complementary to the portfolio we have. So, we now have Jen Anderson. We have a lot of focus on the M&A pipeline. I would tell you we have to add more to the pipeline. But we've started to build out that pipeline. We have a few irons in the fire, and we'll continue to look at what we can add to the portfolio.

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

Joe, a quick correction. We didn't exit 40. We went from 40 – the plan is to go to 33 or 32 this year.

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

I'm sorry. Did I say that?

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

Yeah.

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

Yeah. Okay. No more drinking.

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

But it wasn't that bad.

Joe Ritchie Q
Analyst, Goldman Sachs & Co. LLC

Yeah. Yeah. Save it for after the discussion, Dave.

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

Yeah. Thank you. Thank you, Patrick, for catching that.

Joe Ritchie Q
Analyst, Goldman Sachs & Co. LLC

Thanks for the clarification there, Patrick. There's another question from the audience, but it dovetails nicely with a question I had. It's about the – actually, before I even get to that, the M&A piece, I have to ask you since we're going down this path. Did you take a look at Silent-Aire and Nortek? And any thoughts there?

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

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Look, we are aware of, I think, most of the moving parts out there. So, I don't want to get specific about what we've looked at and what we've passed on and why. But I could tell you that we've cast a pretty wide net. We have – we're trying to be very disciplined about the criteria of what we're looking for and making sure that we stay very disciplined in what we go after and that we really wanted as part of the portfolio. We want all of it as part of the portfolio.

So we have our three pillars of growth that we talked about, growing the core and adjacencies, like – and I would say Chigo fit into that second category – and then very, very focused on recurring revenues and digital capabilities and aftermarket. So, we really want to make sure that we're disciplined that it fits one or multiple of those three pillars. And then we have our two ecosystems, healthy, safe and sustainable building, and cold chain solutions. So, we'll continue to assess especially as it gets into digital and aftermarket capabilities.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

That makes sense. Last question, guys, and I'm going to end on free cash flow. And so, the question from the audience was around progress on improving your free cash flow conversion rates. I think the way I would ask it also is like, look, it was nice to see you guys raised the free cash flow expectation to the year – for the year already. It still implies though less than double-digit free cash flow margins. It just seems to me like this is probably a significant area of improvement. So any color that you can give on your ability to improve that overtime would be helpful.

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

A

Yeah, Joe, we do not disagree that there is an opportunity to improve our free cash flow performance. Maybe as a reminder, from a free cash flow conversion perspective there are two headwinds that we have. One is the JV income, the cash dividends tend to be lower than the equity income. And then of course there is the non-cash pension income that we recognize as well. So as I said there is no cash associated with that. And that's why we came up this year with a 95% free cash flow conversion target.

That being said, clearly we see opportunities to improve that. Whether it's a conversion or whether it's the free cash flow margin as you refer to, one, we see opportunities to improve working capital whether it's receivables, payables, or inventory. All three we see opportunities to improve that. And then from a free cash flow margin perspective you've heard us talk earlier about what we're focused on in terms of aftermarket, some of the more digital revenue streams. With that come higher margin businesses. And some of those revenue streams also are actually less capital intensive than the other parts of our business.

And so clearly we do see a path towards 100% free cash flow conversion in the near term and an improving free cash flow margin as you referred to.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Great. Dave, Patrick and Sam, thanks for spending your time with us today. Always good to see you guys. Have a great rest of your week.

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

Thank you, Joe.

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Patrick P. Goris

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

Thanks for having us, Joe.

Sam Pearlstein

Vice President-Investor Relations, Carrier Global Corp.

Thanks.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Take care, guys.

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