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Carrier Global Corp. (CARR)

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Cameron Lochridge
Analyst, Stephens, Inc.

MANAGEMENT DISCUSSION SECTION

Cameron Lochridge

Analyst, Stephens, Inc.

All right. Good afternoon, everyone. Thank you for joining today. My name is Cameron Lochridge, research analyst here at Stephens. We're delighted to be joined by Carrier, Patrick Goris, CFO; and Sam Pearlstein, Vice President of Investor Relations. Thank you both for joining and thank you all for your interest in Carrier and for joining us in person here in the Stephens Conference and anyone listening thank you for joining. Quick programming notes, so we'll open it up, Pat will make some opening remarks. Right shortly thereafter, I'll start with some Q&A. I have some questions that should last us at or around the 30 minute mark, if not a little bit past. At that point, open it up to questions any questions you all may have. If and when you do ask a question, I'll repeat it into the mic just for those listening over the web, and then we'll pass it to Patrick and Sam.

So with that, again, thank you for joining. Patrick, the floor is yours.

Patrick P. Goris

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

Okay. Well, Cameron, thanks for having us here. It's exciting to be at a conference in person, so it's good to see everyone in person. I would also start by saying maybe that it's been very exciting at Carrier. As you probably all know, we are about to finish our first full year as a newly independent company. It's been a very exciting run so far. We believe we've delivered a tremendous amount of value for shareowners and there is a lot more value to be had and to be delivered. And that's not just from a commercial point of view, meaning there are some secular tailwinds that are benefiting our company and our industry, but also the continued opportunities we have from an internal point of view. There's a lot more and we'll probably talk about the opportunities to reduce complexity, simplify and get more cost out as well. And one of these opportunities that we expect to close early in January is the Chubb transaction. So as you probably know, we announced in July that we have an agreement to sell Chubb. We expect that transaction to close early January. We expect to yield about $2.6 billion in net proceeds from that. And it's going to make our overall portfolio better in different viewpoints.

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One, it will improve our margin profile. Two, we think the divestiture of Chubb will make us a more focused – will make us have a more focused portfolio with a higher growth profile. Of course, with the divestiture of Chubb, we lose some earnings associated with Chubb. And what we've communicated before is that Chubb represents about $0.24 of EPS in 2021. That's our latest estimate. Of those $0.24, $0.18, call it our operational earnings per share, the remaining $0.06 are non-cash pension income, to which we don't describe any economic value. It's our intention in 2022 to offset the dilution from Chubb to $0.24 through operational performance, i.e. growth, profitable growth and share repurchase. And so at the time of the Chubb divestiture announcement, we communicated that we got an additional $1.75 billion share repurchase authorization from the board. And so it's our intention, of course, to deploy that over the next 12 months. So, very exciting times at Carrier, I'd say it's just the beginning, a very driven and excited management team and very well-positioned to continue to benefit from secular tailwinds, but to drive differentiated performance in those tailwinds.

So with that Cameron, I'll turn it back over to you.

QUESTION AND ANSWER SECTION

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Thank you, Patrick, that's helpful. So I guess in your opening remarks, you just mentioned Carrier's pure play status, right, newly minted pure play status. You became a pure play at the height of the pandemic. Quickly moved to position the company differently than it had been under a corporate parent's umbrella. If you could pick one major difference in the Carrier today versus before, what would it be? And if you could answer once in terms of operations and another in terms of capital allocation/corporate strategy?

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

A

Okay, I'll start with the second one, which is a strategy and capital deployment-related. I think the key difference there is the focus on growth. I can tell the environment we're in now within the company, focus number one is what can we do to grow the top line? And I think that's quite different than it was before. And one of the ways I can measure that is before the spin-off, the incentive compensation plans have no growth element to it. It was earnings driven. Today, we changed the incentive plans effective 2021. But the incentive plans have a component that's related to top line growth, organic growth, 40%. The next 40% is driven by operating earnings and then 20% is free cash flow. So I'd say a much more balanced focus for the company and primary focus is growth. Of course, profitable growth and having attractive earnings conversion.

So how does that play out? Being independent, there are no competing priorities being part of the bigger company. Carrier was never the priority number one. If there were investment opportunities and something else came up, more likely than not Carrier was probably not the one who ended up getting the investment funds.

That's different today. It's in our hands. And so we have made significant investments to drive growth. We invested last year $100 million into growth and think of that as sales resources, R&D, digital capabilities. This year we're investing another $150 million on top of that. Even in the middle of the pandemic with all the price/cost headwinds that we've seen, we've continued to focus on investments to drive organic growth. And so I'd say by far that's the biggest change from a strategic viewpoint. And of course, that translates into not just the investments we make from an organic point of view, but also capital deployment. We are in a much stronger financial position today than we were at the time of the spin-off given the proceeds of Chubb coming in as expected, we expect

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early January. We have a lot of firepower for inorganic investments. We will be prudent, we'll be disciplined, but growth is the number one priority. That's on the strategic capital deployment side. I think the other side you referred to was on the operational side?

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Correct.

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

A

There I'd say also very clearly the number one area of opportunity is on the cost side and on the productivity side. Maybe surprising to some, but we are still very complex. It is a tremendous opportunity to simplify what we do. This goes from the number of plants we have, the number of vendors we have, the number of ERPs we have, how decentralized we run some of our businesses. There is a tremendous opportunity to drive cost out. And as I mentioned, it's sourcing plants, logistics G&A go down the list. There is opportunity in all of this. And so of course the opportunity there is to drive cost out, help fund some of the investments that I referred to earlier, drive attractive conversion and then, of course, continue to deliver differentiated long-term value for shareholders.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

So let's talk about some of these areas of growth investing in these areas of growth that you mentioned. First, I just want to start on growing the core, right. So I think you've in the past talked about a 90-plus percent portfolio refresh by 2025. What are your main areas of focus right now and just if you can comment how that's tracking currently?

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

A

Yeah. So I think that 90%, 95% comes from the presentation we made and our HVAC leader shared that for our HVAC business, which is a little more than half of the overall company by 2025, about 95% of the portfolio will turn over. And there are some important drivers there. One, there was one part of the portfolio where we thought that compared to our competitors we were in a disadvantageous position. That's commercial HVAC in North America. We're addressing that. The two elements there that happen in HVAC is one that is a regulation change in 2023 with respect to SEER efficiency rates and in 2025 with respect to refrigerants. Besides that, there is the whole opportunity about more sustainable products, more efficient products. And so what that means is where some of our investment dollars are going is to make sure that we not only address the regulatory changes, but that we invest in differentiated products. And so, yes, the outcome will be and I'd say, not just in HVAC but also in our other businesses like in refrigeration where we're investing in electrified transport refrigeration in Europe, we have a fully electrified cooling unit. We're investing in differentiation, in enabling our customers to drive their sustainability goals and we're in the midst of making these investments and, yes, we're starting to see some of the payback on those investments.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

What about on the geographic coverage and just product adjacencies, right, so over the past year or so I think you guys hired, call it, 600 new salespeople with an emphasis on Asia. How is that productivity ramp going and how do you think about underlying growth in the various Asian markets in the interim?

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

A

Yeah, so I think it's safe to – it's fair to say that the majority of our investments when I talk about investments we made last year, this year, the majority of that has gone to sales resources, but then also R&D and as I mentioned, digital. We have not seen the payback for all these investments yet in sales resources. And that's not surprising. When you hire a new salesperson our leaders will say it may take a year, a couple of years before they're fully productive, and so we haven't seen that yet. And one of the metrics that I like in this area is my selling expense as a percent of my gross margin dollars and so I know that we're not back to where we started. And if that is to be expected, it takes a while before people become fully productive. But, yes, we're making these investments. Haven't seen the full payback yet, but we're seeing some results. Organic growth this year is 13%. If you compare some of our organic growth to some of our competitors, we do believe it's fair to say that in some areas that we've outgrown some of our competitors, some of our investments have gone towards resources focused on aftermarket. We may talk a little bit more about aftermarket later, but this is an area where we believe we have an opportunity that may be larger than our peers only because historically we have not had a significant aftermarket focus. There are too many of our units there that are not covered by a contract or not covered by [ph] a purchase (00:12:44) and so forth.

So, yes, investments being made, including in Asia and frankly in Asia our organic growth is quite higher than it is for the remainder of the company. But I haven't seen all the return, the complete return yet. I think the second part of your question was the expectation in Asia.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Yes. Underlying market growth.

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

A

So, Asia and, of course, China are really important for our business, they continue to be really important. Short-term there are some items that we're watching, of course, including on the real estate side. But if I look at – if we look at the opportunity in China, not just on the HVAC side, but think on refrigeration in places like North America and in Western Europe, 100% of meat and fresh food is moved in refrigerated trucks or trailers. In Asia, it's about 50%. Tremendous opportunity there. If I look at our fire and security segment, if I look for example at a fire detector or smoke detectors, nowhere near the prevalence we have that exist in Asia as we have for example here in the United States. So, tremendous opportunity for growth in Asia and in other emerging markets, clearly the opportunity is there. Long-term, we believe we're quite well positioned. Short-term, we're keeping a close eye as to what's happening on the real estate side.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Sure. Sure. So, you are correct. We are going to talk about aftermarket and digital.

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

A

Yeah.

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Cameron Lochridge
Analyst, Stephens, Inc.

Q

So, one area of focus has been the attach rate for service contracts as chillers come off warranty, right? So, I think the number you have here is at 60,000 you're on track for by year end. And correct me if I'm wrong on that, please. But how much more of your installed base is addressable with this kind of offering? And assuming you do capture it, how meaningful is it for your growth rate and margin...

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

A

Yeah.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

... going forward?

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

A

So, maybe a little bit of context here and why we talk a lot about aftermarket. I think it is fair to observe that historically we've been a company that would sell differentiated products. But once the product was sold, we would not necessarily pay attention on capturing the revenue and profit streams throughout the lifecycle of the product. Having a CEO, Dave Gitlin, who comes from the aerospace industry, that they live and die from the aftermarket business, it's really helped, because obviously Dave sees the value there. He comes from that world. Our aftermarket leader comes from the aerospace industry, has worked with Dave before at UTC, of course. And so there is a significant, call it, I won't say it's a shift from products, the aftermarket and services, it's an end, it's of course we continue to sell highly differentiated products, we want to get paid for these at attractive margins, but we also want to get the life cycle revenue and profit streams that can be associated with those product sets. So, getting back to the chillers, in commercial HVAC we estimate that we have about 300,000, a little over 300,000 chillers out there in the market. Very few of them are covered with a contract, meaning there are very few of them where we have revenue streams associated with them once we have sold the initial sale. And so that's why we focus on finding those chillers and putting them under contract.

And so today we expect that by the end of the year we'll have about 60,000 chillers under contract, that's about 10,000 more than a year ago. But in theory all of our chillers are an opportunity for us. And so we said this before, this year we expect double-digit growth in overall aftermarket sales. We continue to expect that also for next year because there is so much revenue for us to be had. And I'd say it goes beyond the chillers, in residential HVAC there is no reason why the parts that are associated with the residential HVAC units, that those parts sales cannot come from us or through us. Today that is not 100% the case. We started to sell some of the filters that you can buy. If you think about what we have in refrigeration, think about the container units that we have out there, think about the transport, the road transport refrigeration, we have hundreds of thousands of units out there. Most of them are not covered through some type of a contract. And we can provide value to customers by connecting those assets. Once we connect them, we can do analytics, we can track them, we can help save our customers money, drive efficiencies, we can tell them when to replace them. We can increase our customer loyalty. And so the aftermarket, it's a tremendous opportunity for us. And I'd say we're early on because we started late.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

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Maybe shifting to the portfolio optimization topic, right, so you've made some sizable acquisition – or one, at least one sizable acquisition in Chigo earlier this year. What was the primary strategic rationale for that deal? And how has the integration progressed?

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

A

Yeah. So, Chigo is a company we acquired earlier this year. It's a China-based company. And Chigo has VRF technology and is basically a different type of technology to cool and heat units or buildings. And the attractiveness of VRF is the following, the VRF market, back in 2015, we estimated that the VRF market was about half of the commercial HVAC market. Today, it's about the same, faster growth rate. We did not have that technology in-house. By acquiring Chigo, we acquired the technology in-house and we have low cost manufacturing. And so basically we now have direct access to a faster growing part of the HVAC industry, having our own VRF technology. So, it was really important for us to have access to that technology. It's still early with the integration, but clearly we're already seeing some of the benefits and including some of the benefits that initially we may not have assessed as much as we thought we would. For example, in Europe, we have a VLO business. It's part of our HVAC business where we're focusing more on heat pumps. As you probably know, heat pumps are becoming more important in Europe. We already have seen some synergies between what Chigo does in Asia and some of the heat pump opportunity we see in Europe. And so there is already a closer cooperation there than we had before the acquisition.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

That's great.

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

A

And so it's an example of a smaller size acquisition that complements our existing technology, is somewhat of an adjacency, also increases our geographic footprint.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Some of the smaller, more tuck-in style acquisitions you made, Nlyte, BrokerBay, Cavius was the three recent examples. All different capabilities but digital is a common theme across the group I'd say. What's the underlying strategy in acquiring these smaller, more digitally-enabled platforms? And is there an end goal to the overall digital portfolio at some future date?

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

A

Yeah. So, if I look at the three elements we look at for acquisition, it's either to accelerate growth in our core business, expand either from a geography point of view or from an adjacency point of view, or three, help us with aftermarket sales or digitally-enabled services and the acquisitions fit in there. More and more and this is not unique to us, but you see this with many other industrial companies, more and more the differentiation is not just the actual hardware, but it's also the smartness of the product. And that's where some of these acquisitions come into as well. And that's why they have some element of software. They have an element of recurring revenue that we find attractive as well. And so it's just one additional way given our financial strength we have now that we can make acquisitions to enhance our overall differentiation and differentiation includes differentiation through what I call smartness or more software-related products.

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Cameron Lochridge
Analyst, Stephens, Inc.

Q

Sure.

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

A

Or capabilities, I should say.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

You mentioned Chubb earlier, we spoke about Chubb.

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

A

Yeah.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Beijer was another high profile divestiture. What are the criteria that you look at when you're deciding when and where to prune the portfolio and in terms of, if we think about how much were to chop, maybe it may not be the right way to put it, but is this fading as one of your top priorities now that bigger deals have been announced?

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

A

No. It continues to be a focus for us. And the reason is and I mentioned that at the beginning that we're still a large, complex company with opportunities to simplify. And one dimension of simplification is looking at your portfolio and assessing, are there parts of your portfolio today that made it in line with our strategy. We may not be the best owners and we may not be attracted by the financial returns, and I think it's absolutely fair to say that we continue to look at that across the three segments that we have. And if it doesn't fit in with our healthy, safe, sustainable, intelligent buildings [ph] or cooltain (00:23:25) solutions that would be a first, call it a first hurdle to save. If it doesn't fit with that then why are we the best owner? After that is, of course, is what's the attractiveness from a return on invested capital point of view, the other financial metrics. But that exercise continues, it's – I will only say that it's unlikely that there are other elements the size of a Chubb could happen, but at this point I'd say that's probably unlikely.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Sure. On cost management, so Carrier 700, I'm sure it's a program that most of those in the room that are listening are familiar with. But for those that may be new to the story, maybe just give us an overview of the Carrier 700? And then, over the past 12 months, there's been some significant inflationary pressures, right? It's not just a Carrier thing, that's across all industries that's perhaps made that $700 million cost out perhaps more difficult to achieve. Cutting through that noise, though, well, what are some of the core principles that Carrier has adopted since becoming a pure-play for ongoing cost management? And how much of that work is left in front of you to implement?

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

Yeah. So, first, some context on Carrier 700. When we spun out last year, we launched a program called Carrier 600. And the objective of the program was to take out $600 million in cost, and that was a net cost out, meaning net of inflation. And last year, we delivered about $225 million.

Sam Pearlstein
Vice President Investor Relations, Carrier Global Corp.
A

$250 million.

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

$250 million. This year, we've had a – our target for this year was $225 million. Given the significant headwinds from inflation, it's become a whole lot more difficult, of course, to get net savings of that magnitude out. So in addition, with the divestiture of Chubb that's upcoming, we will push the reset button as to what we'll call it, whether it will be called Carrier 700 or something else. But the essence and the focus on getting cost out is not changing. The opportunity is no different, and in terms of the – I think you mentioned the core principles and some core principles would be no sacred cows, everything is on the table, and we do what's best for the company rather than what's best for an individual unit. I mentioned earlier some of the complexity but we have – we started with over 50 different manufacturing facilities this year, we'll end up with a little less than 50, that is continued opportunity there.

Historically, we have not invested a lot in automation. That's an opportunity throughout our manufacturing footprint. Same thing with logistics in a warehousing point of view. It's more of a spider web than we need it to be, again an opportunity there. Most of the companies that you all cover, I'm pretty sure they started to implement shared services 10 or 15 years ago. We started last year, we're in the first inning. Maybe the first thing early on, and it is what it is, but it just highlights for us how much opportunity for us there is in getting cost out of our system, which of course will enable us to reinvest into our business to drive profitable growth, while at the same time delivering an attractive conversion, earnings conversion. And so it is a different mindset than we've had before, much less decentralized than what we've done before. And so and looking at it what's best from an overall company point of view.

Cameron Lochridge
Analyst, Stephens, Inc.
Q

Sure. You mentioned the conversion there, the core conversion, right. I think a number of times you all have mentioned the goal of high 20s to 30% core earnings conversion, that's the target. If we think about just that in the context of just overriding imperatives on achieving that in any given year, particularly in terms of your pricing strategy and willingness to add fixed cost as the business grows, how should we think about that?

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

My answer – I have two pieces to my answer. The first answer was over longer periods of time, do we expect high 20s to 30% earnings conversion, yes. And that would include the net of the – call it the volume leverage, assuming mid-single-digits of organic growth would include the benefit of volume leverage, the benefit of driving productivity. And that would then be offset by reinvesting in our business and covering items such as merit. That's kind of a reasonable model to think about our company. And short term, given the tremendous price and cost that we've seen this year and expect also next year, if price cost is neutral, it dampens the earnings conversion. It's

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just the way the formula works. So excluding the price-cost equation, actually, I would expect 2022 earnings conversion to be north of 30%, but only because there is so much opportunity from a cost side, but on the long-term side, high 20s, close to 30% conversion that would include the net of reinvesting in our company.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Sure.

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

A

Yeah. That's the model that we're comfortable with.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

We are approaching the bottom of the hour. So at this point, if there are any questions from the audience, happy to take them, otherwise I have questions I can keep this going. But I do want to open up the floor to any you all may have.

Patrick, maybe just shifting to your HVAC end market and some trends in those varying categories, right; so light commercial, it was an outperformer I believe in 3Q. Can you just speak to the drivers of that, maybe in terms of replacement versus new build dynamic? And then on a related note, we'll just start there, what are some of the drivers of that outperformance?

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

A

Yeah. So light commercial is about 80% replacement, 20% new and it's probably the element within our HVAC portfolio that has come back the last from the pandemic. And so had tremendous growth in Q3, I think it was 40%...

Sam Pearlstein
Vice President Investor Relations, Carrier Global Corp.

A

In terms of the order activity.

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

A

So, order activity of 40%. Our field inventory levels are still down in light commercial so I think that bodes well for the future. But if you think light commercial, that's where some of the restaurants come into play, that's where some K-through-12 comes into play as well. K-through-12, of course, we've seen some government benefits that school districts are using to make some investments. But I think it's an element of – the strength we're seeing is an element of it's the last part of our HVAC business that is picking up. We have a really strong position. We have a strong portfolio and we're working really closely with some of our customers, for example, K-through-12 with the government benefits that I referred to. We're actually reaching out to school districts. We have a playbook because they know there is government money available to them.

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They don't necessarily know how to apply for the money. And we're very happy to help them to say, you know what? This is how you can do it. Let us help you and of course we have some products we'd like you to invest in that will enhance the air quality within your schools.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Sure. I think, in addition, you announced, was it a 12% price increase...

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

A

Yeah.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

...light commercial...

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

A

Up to 12%.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

...up to 12%. If we think about that in terms of the potential margin tailwind, what are some of the puts and takes we should think about going to 2022 from light commercial?

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

A

Well. First of all, light commercial in itself is a higher margin business for us, and it's close to the margins in residential HVAC. So if light commercial does well, generally speaking, that's good for overall company margins. The 12% price – we'll need that 12% or up to 12%. We believe we need up to 12% price in light commercial to be price cost neutral next year. Price cost neutral basically dampens margins. And so that then in itself was not going to be a margin accretive impact, it actually would dampen our margins. But obviously our intention is to do better than the price cost neutral. And if some of the input cost headwinds subside, then of course it's our intention to hold on to every penny of the price increase that we've realized.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

Sure. On residential, I think channel inventories from 2Q to 3Q were down high single-digits. On an absolute basis can you characterize their level at the end of 3Q and then how have you balanced leaning into some of the robust demand in residential with avoiding oversupply in a short cycle market?

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

A

Yeah. So, I may need some of your help here with the numbers, but, yes, our inventory levels, they dropped sequentially. They're still up and it's in units that we measure it. They dropped Q2 to Q3, still higher than 2019 and 2020, but it's driven by coils, not by splits. And coils actually, we believe it's an area given some availability in the

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market, including some of our competitors, it's actually an area where we believe we actually picked up some share. And so I'd say that by and large we believe that our inventory levels at the end of Q3 were pretty much in balance. And so nothing really there to call out from a concern point of view at the end of Q3. Sam, anything you want to?

Sam Pearlstein
Vice President Investor Relations, Carrier Global Corp.
A

No, I mean, I think that resident – we said that we expect residential inventories to be relatively flat by the time we get to the end of the year. The movement had still been strong through the quarter, which is ultimately the product going out from the distributors to the end customers.

Cameron Lochridge
Analyst, Stephens, Inc.
Q

Last on HVAC trends, so in applied, right, in Q3, I think sales were less robust here, what would you call as a driver there?

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

In applied, so that's the applied equipment and commercial HVAC, our sales were down mid-single digits in Q3. Our orders were up 15% in Q3 and our backlogs were up 20% year-over-year. And so continued strong order intake. And what we actually saw in Q3 was our Charlotte facility in North America, we had some efficiency issues and output issues and that impacted our output. And so I would not say that there is anything, no red flag that we see, we know what happened in Charlotte, we're addressing it. Order intake and backlogs continue to grow.

Cameron Lochridge
Analyst, Stephens, Inc.
Q

Great. I'll see if the audience has any questions again at this point. All right. Moving to what I'm going to call the lightning round. All right. A couple of quick hitters here. So, first just on heat pumps. I think they comprise 30% of your commercial sales today, up from 15% five years ago. Is most of that difference in market preference or share gain, and then compared to the rest of your portfolio when you were spun off, how would you characterize the previous-level investment in this product category?

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

It's, first of all, the growth we're seeing in heat pumps is driven by the two items you mentioned. One, clearly there is a element of customers moving towards heat pumps. Customers have their sustainability goals. They have decarbonization commitments. We can help with that, the heat pumps is one way we can help with that. So, clearly there is a market element to it, but it's also an element where we've made some investments to have a differentiated portfolio. And so we do believe we have an attractive portfolio in heat pumps and we're seeing the benefit of that and that will not – we see that continue for quite a while.

Cameron Lochridge
Analyst, Stephens, Inc.
Q

Great. On ESG...

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

A

Yeah.

Cameron Lochridge
Analyst, Stephens, Inc.

Q

...what is the core of your ESG story that you want to make sure investors are aware of?

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

A

In short, we are at the epicenter of companies who want to reduce their carbon footprint and want to increase their sustainability given that all companies have some form of HVAC energy consumption, companies use coal transportation. We're at the middle of all of that and we are really well positioned to help those customers reduce their carbon footprint. We're in the middle of it. We help our customers achieve their sustainability and decarbonization commitments. And it's a great position to be in, we're making investments to ensure that we continue to have a differentiated portfolio, not just in HVAC, also in other segments, including refrigeration. I talked earlier about a fully electric unit we're now selling in Europe. The take-on is really good in the market. And so we're very excited to be in that position.

Cameron Lochridge
Analyst, Stephens, Inc.

Patrick, Sam, thank you both very much for joining. To all that came to see the presentation and for those watching, thank you for participating and enjoy the rest of your meetings.

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

Thanks, Cameron.

Sam Pearlstein
Vice President Investor Relations, Carrier Global Corp.

Thank you.

Cameron Lochridge
Analyst, Stephens, Inc.

Thank you.

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