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Carrier Global Corp. (CARR)

BofA Securities Global Industrials Conference

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CORPORATE PARTICIPANTS

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

OTHER PARTICIPANTS

Andrew Obin
Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

[Abrupt Start]

Patrick P. Goris

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

...go through some slides to introduce our company because while we've been in business for 120 years, we've been a independent public company for less than two years. So, since we invented the air-conditioning a long time ago, we've become a global leader in healthy, safe, sustainable, intelligent, building and cold chain solutions. As you can see on this slide, we have a global footprint and we have leadership positions in many of the end markets in which we operate.

We combine technology differentiation, our expertise and digital capabilities to deliver value to customers. And more and more frequently that value to customers includes helping our customers achieve and deliver their sustainability commitments, lower carbon emissions, lower energy efficiency. So, we play an increasing role achieving our customers, helping our customers achieve their goals. So, earlier this year, we sold Chubb, which was about $2 billion in revenue. Since the sale of Chubb, our sales in EMEA are about 25% of our total sales and sales in Russia and Ukraine account for about 0.5% of our total sales.

So, we organized in three segments. As you can see on this slide, you can see what technology we deliver in each one of our three segments, but more importantly, what value we deliver to our customers. In essence, what we provide to customers is increased indoor comfort, increased indoor air quality, healthier, safer, more secure homes and buildings and the ability for customers to deliver fresh food and medicine to customers globally. And as I mentioned earlier, we also help our customers achieve their sustainability goals. As you can see on the slide, each one of our three segments not only has a global footprint, but is a market leader in many of its segments that it operates in around the globe. We believe we're in a very attractive industry with significant secular tailwinds. We believe we're actually at the epicenter of very attractive tailwinds.

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First of all, COVID has reminded us that indoor air quality is really important and ventilation, of course. Second, more and more, as sustainability becomes more important across the globe, in all parts of the globe, we play a really important role with helping our customers achieve their objectives. And digitization is providing another secular tailwind to us. Being able to capture data, organize the data, extract value from that data helps us deliver additional value to customers and helps us provide additional services to customers and increase our recurring revenue streams.

Finally, a growing middle class is also a tailwind for us. As people get into the middle class, they expect more comfort, they expect more HVAC, but they also expect more fresh food and a delivery of not only fresh food, but also of medicine. All of these secular tailwinds are benefits to our business.

About differentiation, our differentiation is not just our unmatched installed base, our exceptional brand recognition, but also, of course, our technology. It also now is the increased integration between our Fire and Security and our HVAC segments and technologies. It also includes now our digital platforms Abound and Lynx, which I'm sure we'll talk a little bit more later and our ability to provide new business – new services and value to customers such as sustainability as a service. For example, for some customers in the world, we not only manage their installed base from an HVAC perspective, but also help them reduce their energy consumption. And so more and more, we become a more important partner to our customers around the globe.

For those of you who have followed Carrier, you hear us talk a lot about aftermarket. This is an area where we believe historically we've not been as strong as we needed to be and can be. And so what have we done? First of all, our CEO, Dave Gitlin, comes from the aerospace business, as does our aftermarket leader. As you know, aerospace, that's where they make their money in aftermarket.

Today, we think our aftermarket business is about $4.5 billion. That is only about 25% of what we estimate the market to be for our own equipment. Meaning, of our installed base, we think the aftermarket is 4x the $4.5 billion you see here. So we see a significant opportunity for us to grow in the aftermarket and we've seen the outcomes of the investments that we've made in this space.

A few years ago, our aftermarket was growing low-single-digits each year. Aftermarket has been growing at about 10% in the last two years. It's not just having hired the right people. We have a playbook that we implement. We've made investments in technology, but also in sales resources to increase our aftermarket. And it's a very attractive business for us because one, it's with existing customers. They have our equipment, after all. But also from a margin perspective, the gross margin for this business is over 10 points higher than the company average.

So a couple of weeks ago or about a month ago now, we had our Investor Day and we shared with our investors our value creation framework. And that is what you see on this slide. It all starts with our target of 6% to 8% organic growth, over 50 bps of margin expansion every year, a lower ongoing tax rate of about 22%, 100% conversion of net income into free cash flow and that all combined with value-add capital deployment, including a growing dividend, acquisitions, and share repurchases. And as a result of all of this, we expect long-term double-digit EPS growth.

With respect to capital deployment, our priorities for capital deployment are very clear and they have not changed. We fund organic growth. We fund inorganic growth. We fund a growing and sustainable dividend and we focus on share repurchases. Earlier today, actually less than an hour ago, we issued a press release where we announced a $1.15 billion tender offer for our debt. Now, a few weeks ago, I just announced that we were targeting a $750 million debt reduction for this calendar year. So, $1.15 billion is $400 million more than that. Our plans have not changed; but given the acquisition of Toshiba, we are rebalancing our debt between US dollar-denominated debt

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and yen debt and so we expect, as we get closer to the closing of Toshiba, to issue $400 million of yen-denominated debt; so no change there.

Another word here on capital deployment or an update, I should say, we had a accelerated share repurchase program earlier this quarter, so an ASR. That ASR is completed and we now expect that total share repurchase in Q1 will be about $750 million.

Talking a little bit about acquisitions, we have a significantly enhanced financial position, which enables us to play offense on capital deployment. The priorities for acquisitions are really simple. One, anything that can enhance our sustainability leadership position in the market, two, anything that can help us expand our market into higher growth areas; three, accelerate organic growth, and four, anything that can help us drive increasing aftermarket sales and increasing revenues.

And if you look back at the Toshiba acquisition, which we announced in February, it checks the box on many of these priorities. Toshiba – the Toshiba acquisition brings us VRF technology, a faster area, a faster growing area of the commercial HVAC market. The Toshiba acquisition also helps us with heat pump technology, which across the world is increasing in importance, given, of course, the increased push towards more efficient levels of or sources of HVAC.

So, this bring me to a slide to cover some of our ESG activities, whether it's respect to our people, our planet or our communities, we have made significant commitments with respect to ESG and management is being incentivized to deliver on its commitments. In other words, executive management compensation is influenced by how we perform on these goals. And these goals are not just good for the planet, they're not just good for our customers, but they're also good for Carrier. And this is an example of that.

You see here some of our products that we recently launched and you see on the second column, you see the greenhouse gas emission reduction that we can help our customer achieve as a result of those new products. And you see the reduction in ongoing operating costs for our customers. And so, we make important investments that not only benefit the planet, help our customers achieve operational efficiencies, help them achieve their sustainability goals and clearly, of course, a significant benefit to Carrier as well.

And one of the examples I'll mention here, and I think it's the first one here on the list, is what we do from a transport refrigeration point of view. This is an area where we believe we're the clear market leader. We have fully electric units available. We're running in 11 countries, mostly in Europe today. We're coming out with additional products and this is an area where more and more diesel-fueled cooling units will be replaced with fully electric units. And we are very well-positioned to benefit from that going forward.

So, it's not just words. We actually act upon our commitments. And although we've only been public for less than two years, increasingly we are being recognized by many third parties as a really important player, not only in ESG, but, of course, in the sustainability movement as well. And the list of companies or third parties that is recognizing that leadership is only increasing.

So, with that, why Carrier? There are some important secular trends that we are benefiting from. We have a really strong market position, a strong brand name. We have strong technology that differentiates us in the market space. We have significant levers or self-help levers, I should say, available to us, not just from a cost point of view, but also from a commercial point of view. Think about the aftermarket opportunity that I referred to. And, of course, from a portfolio point of view. We have done some work on portfolio simplification, the Chubb sale, reduction of joint ventures, but we see additional opportunities ahead of us. We have an attractive algorithm or

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financial framework to create value that I shared with you. And a significantly improved balance sheet really sets us up well for offensive capital deployment.

Finally, before we get to Q&A a couple of words about our first quarter. At the February earnings call, I mentioned that we expect about $0.45 of adjusted EPS in Q1. Through February, so through two months, our pace is slightly ahead of that. But clearly, March is always the most important month of the quarter. And so we'll see how it plays out. But so far, a good stronger start to the year than what we expected about a month and a half ago.

So, with that, I'll come and join you, Andrew, for some Q&A.

QUESTION AND ANSWER SECTION

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Well, thank you. Thank you, Sam. So, that seems to be a good incremental news on the quarter. So, that's a very good start. And maybe...

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

So far.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Yes, so we'll take that.

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

Yes.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

So, look, maybe we can talk about sort of some of the underlying drivers of this excellent performance. So first, why don't we talk about product development, since becoming a standalone company, seems Carrier has become a lot more focused on investing in new products. And that was very evident when I was visiting your booth at AHR and just the excitement of people just talking about what's out there and just how it allows you to really go after the market. Can you talk about what types of products these investment dollars are going towards? And how should we think about the key parts of the portfolio that will drive out growth?

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

Yeah. Thank you for that question. So, we have made significant investments in the last couple of years throughout the company to drive differentiation, to drive future growth. If you just look at R&D expense, and so that's not all of our investment, but it's an important recipient of it. Our R&D expense has basically gone from about $400 million to $500 million, so that's $100 million more, about a quarter more just in a few years. So, where is this investment going? If I look at some of our segments, within HVAC, a significant investment related to

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the 2023 new regulations coming out in residential and so, increased levels of – increased minimum levels of efficiency that's driving a significant wave of additional investments in new capabilities. Those units will be higher cost, higher price units. But we expect the margin dollars to be higher and we expect the margin percent to be the same or higher. So, investments in residential HVAC related to regulation changes.

Also, within HVAC, we've made significant investments in commercial HVAC, specifically mag bearing, commercial HVAC equipment applied also especially within North America...

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

...was probably the one area where we thought that from a competitiveness point of view, we could do better. The third area, I would say, within HVAC is heat pumps.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yes.

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

A

Heat pumps is becoming more important. We already sell a lot of heat pumps in the US, but with more and more focus on sustainability, heat pumps are only becoming more important. And frankly, as I just mentioned, the acquisition of Toshiba really helps us in this space as well from a heat pump perspective, including and, for example, we'll see more and more in this part of the world here in Europe.

Other areas of investment, if I think of transport refrigeration, I just talked about the market-leading position we have in electrification, a key area of investment for us. More investments coming out in this space. Other investment areas, we talk about our digital platforms, Abound and Lynx, provides additional value to customers, enables us to grow our aftermarket business, and frankly get additional pool for our equipment sales. So, overall, the way you can think of our investments is more differentiation, better positioning – even better positioning for sustainability leadership and increased investments in areas that can generate more aftermarket sales and more sticky revenue.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

So, maybe with that, if we can segue into services strategy. Could you talk about the progress Carrier has made on growing the services attachment rate of the install base and how are you investing in the sales force and channel to sell long-term service contracts for both the existing installed base and new products?

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

A

Yeah. So, in the presentation, you saw that our aftermarket sales are about $4.5 billion and I mentioned it's 25% of the market associated with our install base and so it's really important. We've made investments in people,

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processes, playbook. All of our equipment today, whether it's commercial HVAC equipment or in transport refrigeration, we're making sure that it is connectable, meaning that we don't have to find it and connect it, but it's connectable both from day one when we sell it.

The measure we used to track was attachment rate. And we started a few years ago and our attachment rate was 20%. By that, what do we mean? We sell a unit, think of a chiller, and after one year after installation, we see can we attach a contract, a service contract to it? That rate was only one in five, only 20%. That is now close to 40%. And so clearly, we think it needs to be 100% and we're really focused on increasing that.

Now, that's only part of the opportunity because that's only for the new equipment that's sold. What about all the units out there in the market? And so that gets us really to coverage. If you look at our chillers in the markets, it's only – it's over 330,000 units out there. Only 60,000 of them are under contract today. If you think about our transportation units, it's 1.8 million units out there. The part of it that's under contract is de minimis. And so, it's all about finding the units, connecting the units and selling the value to the customer – and for the customer, the value could be increased uptime, i.e., we can predict when a cooling unit will shut down or will fail and the customer clearly will not lose the content of that. But the benefit can also be how do we help our customers reduce their energy consumption? And so, connecting the units is really – a really important step in being able to attach additional value to it and that generates additional value streams, more customer intimacy and in turn, we expect that to provide additional pool for equipment.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

As you think about your service strategy, how should we think about you investing in the sales force? And what role does it play? Because I think one of the messages at AHR was in fact, on applied side is that you actually do have the sales force now going out with this terrific...

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

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

...product.

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

That's right, Andrew. And at our Investor Day, we showed a chart of how our head count, our sales head count has moved up in the last few years and it has moved up significantly. I think it's about 20-or-so-percent.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

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Of that, one-third, about one-third, is focused on the aftermarket opportunity. And so, I think it's fair to say, as a rule of thumb, it's easier to get additional volume with existing customers where you are already there versus just trying to get additional customers. And so it's our OEM equipment. We only have 25% of the aftermarket and we need a bigger share. And that's what we're going after.

Andrew Obin Q
Analyst, BofA Securities, Inc.

So maybe we can switch to resi HVAC, so both you and some of your competitors talked about the resi HVAC replacement cycle shortening, manufacturers are adding resi capacity. Seems like 2022 the cake is baked, that 2022 is not an issue. So, what are demand tailwinds this year and what are the structural tailwinds longer-term? And also, maybe we can talk about also about the risks to resi outlook this year, is it consumer confidence, interest rates, geo-politics, what are you guys watching?

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

So, on residential HVAC, I would not agree with you that the year is baked...

Andrew Obin Q
Analyst, BofA Securities, Inc.

Right.

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

We're two months into the year, as I said, a little bit of start than what we expected. Now, first of all, residential HVAC remains a short cycle business.

Andrew Obin Q
Analyst, BofA Securities, Inc.

Yeah.

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

It is typically not a book-and-build business, and so, generally speaking, our visibility in residential HVAC is less than some of our other businesses that have longer lead times. That being said, we've had some really good years in residential HVAC, you mentioned some of the reasons. We're working from home, what we believe a lower life cycle in terms of years, given that...

Andrew Obin Q
Analyst, BofA Securities, Inc.

Yeah.

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

...it gets used more often. We've also seen a lot of strong – we're also seeing a lot of new construction in the US...

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Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

...we think we're a little overweight new construction in residential HVAC. We've seen a lot of people buying and selling houses. That tends to be a benefit to us as well because every time you buy or sell a house, someone checks on the HVAC equipment and so on. So, our view for residential HVAC this year is high-single-digits organic growth. Think of volumes being flattish and high-single-digits driven mostly by price.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

Now, our movement has remained strong, which is a key indicator for us. And so, at this point, there is nothing we see that indicates a significant change in the trajectory run for residential HVAC. So, thinking a little bit further out now. There are some tailwinds we see for residential HVAC. 23 new regulations coming out.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

I mentioned that. That means new units, more efficient units. They will be higher priced. They have a higher cost, higher priced, more efficient. And in 2025, there are new regulations coming out with respect to refrigerants. Generally speaking, those tend to be tailwinds.

The other thing we see in residential HVAC, and that's now more on a global basis than rather just on the US basis, is given the increased focus on sustainability, and as I mentioned, increased focus on electrification, and therefore heat pumps, given also some of the acquisitions we've made, we've seen some – we see additional opportunities for residential HVAC in other parts of the world, including heat pumps, including outside of the United States. So, yes, there is a cycle in residential HVAC. We remain bullish on this business for the long term.

Clearly, it's a very attractive business. We have a market-leading position in this business in the US and we continue to invest to have a very differentiated offering. And I would say this is also an area where we're focused on aftermarket. And an aftermarket for residential HVAC includes the MRO, the parts. We have not done as well as we could in ensuring that if there are parts associated with our installed base, meaning some replacement parts that these parts come through us. And so that is an area where we're putting a higher emphasis on and we expect higher sales, aftermarket sales, not just as a company, but also within residential HVAC.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

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And so when you're saying clearly here today, you said the business is doing better, but you sort of challenged my assertion that the cake is baked. It's always good to have conservative management, but so what are the risks? Is it consumer confidence, I think some executives and some salespeople we've talked to, sort of interest rate seems to be a focus, geopolitics, driving commodities up, like what keeps you up at night?

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

A

Well, couple of things. One is we've – generally the industry has been able so far to pass on pricing. And actually within residential HVAC, we just announced another price increase effective in April. It's about almost it's 9% light commercial, commercial HVAC and residential HVAC, all in North America. So far, we have been able to yield the results from those price increases. Can that last forever, can you just price up indefinitely? Clearly not, but I don't think we're at that limit yet.

In terms of other things that keep us awake, uncertainty is never good for business. And so clearly, with what's happening now in parts of the world, including in Russia and Ukraine, could it have an impact on demand? It could, we have not seen that yet. Actually, through two months this year, we see that demand, and I see demand generally not just in residential HVAC area, has continued to remain strong. And so, to answer your question, on the macro side, uncertainty doesn't help.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

We haven't seen the impact of that yet. Pricing, clearly, there will be a limit to that. I don't think we have seen that at this point.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Got you. So, shifting to digital solutions, what's the opportunity to attach software solutions like Abound and Lynx to Carrier's installed base? You've mentioned that every product shipped now has a connected component, so how much incremental revenue margin does a connected product generate versus an unconnected product? And how receptive are the customers about this embedded digital capability and other than being receptive, do they care? Yeah.

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

A

Well, it's up to us to show the customers that there is a value by connecting. And so, that's why we have the playbook for our aftermarket and because the digital capabilities are a key enabler to grow our aftermarket business. And so it's up to us to talk to a company and say, well, if you install Lynx, not only will you know where your equipment is at what time, not only will you know what the temperature fluctuations were of your transportation throughout its journey, not just in our trucks, but throughout its journey. But also, if we can predict to you when a certain piece of equipment will fail or we need to provide preventive maintenance, the cost of one lost load may offset years or more of just what it costs to connect the unit.

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Now, the value we get or the revenue we get from a connected unit is not going to be, if you add all this up, is this going to be many hundreds of millions of dollars? Not tomorrow, but what it enables us to do – yes, we get some recurring revenue upfront, but enables us to get more service and aftermarket revenue. And it enables us because we have more customer intimacy, customer loyalty, it enables us to then sell more equipment to the customer. And so, the biggest opportunity may not – is not the additional digital sale, it is the services and it is the equipment. And an example we have provided is on the commercial HVAC side. We estimate that the life cycle revenue may be 10X the original value of the equipment sale. And so that is the order of magnitude that is attractive to us.

Now, is it 10x for every single part of our portfolio? No. But it gives you a good idea as to how much revenue and profit is associated with that because aftermarket, as I mentioned earlier, the margins there, the gross margins there, are 10 points or more higher than the company average gross margins.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Got you. That makes sense. Thank you. Maybe we can talk about sustainable buildings, sustainable cold chain. So, how often do sustainability and energy efficiency come up in conversations with building owners, architects and engineers? And how do you think about retrofit opportunity that's out there? And how does the evolution of regulations play a role?

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

A

Yeah. It is extremely important and it comes up all the time. Many parts of the world, including in the United States, for example, New York and California, are coming out with new regulations. What that drives people, building owners and operators, is it drives – every time we talk with them, sustainability is becoming a more important topic of the discussion. Many companies that you all cover, they've all made commitments with respect to ESG and carbon emission reductions. 40% of the emissions of buildings are the HVAC systems. Chances are they cannot achieve their commitments to their stakeholders without making investments in HVAC or upgrading their HVAC equipment. So, the short message is, Andrew, it comes up all the time and regulations just help and further accelerate it.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

So, speaking about VRF opportunity, how are you thinking about the VRF opportunity globally? You did buy Toshiba Carrier Corporation. So now that you own it, how does it change your VRF strategy and maybe looking at VRF by geography and what can you do differently with Toshiba now that you own it in terms of product fit?

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

A

So, maybe some context, why are we attracted by VRF technology? It's a faster growing space of the commercial HVAC market. It grows about 2x what commercial HVAC applied growth rate is. And so, a faster growing area, and we have not had direct access, meaning 100% owned by Carrier access to that technology, we acquired Giwee about a year ago, a smaller player in this space. Now, with the acquisition of the remaining shares of our joint venture Toshiba, we now own 100% of that technology which is really important. So rather than just being limited to some of the distribution in some parts of the world and the sales associated with this, we now own the whole technology and the go-to-market piece, so really important.

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And what it also brings in, and I mentioned this earlier, it brings us access to improved technology with respect to heating pump, heat pumps. And in this part of the world, including in EMEA, there are more and more incentives for people to, as they replace equipment to install heat pumps, rather than heating from different – using different sources of energy. So, I would say a acquisition that fits in perfectly with our priorities, more sustainability, enhances our position in this space. Actually, we are one, if not the – if not the only one, we are one of the only ones now of US companies in this space that has direct access and owns direct VRF technology that we can use and expand into other parts of the world, not just Asia. We sell VRF in the US. It is also available here and sold in Europe and heating pumps will work everywhere in the world.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

No, I did think it was very differentiated transaction. So that makes a lot of sense. Fire and Security, what are the macro tailwinds and risk of Fire and Security this year? And what do you see as structural growth drivers for this business over the medium term? And once again, what areas are you investing in now, and particularly now that you've sort of exited Chubb, how does that change what you're doing there?

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

A

If you look at our Fire and Security portfolio now, excluding Chubb, it's basically a combination of high margin, high return on investment businesses that each are either number one or two in their industry globally. So we're really attracted by that. So what's driving demand for this? Well, most people in the world like to live or work in a building or a home that's safe and secure and that's where that segment comes in.

Fire security for buildings, safer homes, now in some parts of the world, we take this as a given also because of government regulations, whether it's here or whether it's in the US. But most parts of the world, the regulations with respect to fire protection in homes or in buildings is nowhere near what it is in, for example, here or what it is in the United States. And so, an important tailwind for our segment, for our Fire and Security segment is growth, including growth outside of the US and includes our ability and opportunity to influence government regulations.

Our residential fire business, for example, we have a very strong leading position in the US with our Kidde business. If the regulations would be the same across the world versus what they are in the US, this business could be significantly larger than what it is today. And so we continue to invest in increased differentiation, increased differentiation to be more attractive in some other parts of the world. And part of our investments, frankly, is also in time in influencing, as I mentioned, regulations across the globe because we know that will not just benefit individuals wherever they live or work, but it will be good for business for Carrier as well.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Got you. So another sort of hot topic into the year-end and clearly you've provided various sort of relevant updates. But how should we think about cost framework, right? Could you talk about the evolution of the cost framework? [ph] Does this move from Carrier 700 turn (00:34:35) your gross productivity target and how has the culture of cost control at Carrier evolved since becoming a standalone company?

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

A

Good. Well, I'll start off by saying that managing costs and the focus on productivity throughout the company, it's in our DNA. Every single function within the company is expected to drive costs down every single year and look

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for efficiencies. Whatever we called a program, whether it's Carrier 700 or something else, that does not change and has not changed. So, our focus on productivity enables us to make investments to grow the company, enables us to pay the annual salary increases and enables us to expand our margins. Now, about how we named it. So, when we spun out, we had a program called Carrier 700. We're going to drive $700 million of cost out over three years and we've changed that. And now we target 2% to 3% cost out of our entire cost base every single year.

So, why did we change it? Well, our portfolio changed. By selling Chubb, part of our cost base has changed, but our focus on cost reduction does not change. The Carrier 700 was meant to be a net number, meaning gross productivity minus the headwinds of inflation. In a high inflationary environment, that becomes confusing. So, we made it easy. You take our net sales minus our EBIT. That's our cost base. We target of that 2% to 3% cost out every single year, which will help us fund the investments, our annual merit, and will help margin expansion. And as I mentioned, every single part of the company is targeted with cost out; not everyone to the same extent. 2%, 3% is the average. Our plants, their target is well over 5%. Other parts of the company are less than that.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

That is great. Maybe in the remaining time, let's sort of shift to inventories because that's a big debate. We get [indiscernible] (00:36:38) data, get incoming calls like is this data real? So, how do you balance inventory management with the current state of demand? A, sort of higher levels of inventory at the OEM level? Do we need to sort of – given the more uncertain world going forward and maybe more volatility in the supply chain, is that sort of a more permanent feature? And then how should we think about channel inventory? Because as I said, this [indiscernible] (00:37:10) data comes out, it goes down on days inventory, but it's up. So, two separate parts, but a big debate with the amount of investors.

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

So, one from a channel inventory point of view and I think we've been talking specifically about resi, we think we're well balanced there. And so we're not seeing one way or the other that we're out of balance. Our inventories are higher than they typically would be.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

And there are two main reasons for that, one, it's on purpose. Given supply chain shortages and challenges, we have tried to build some more, call them, buffer stock or safety stock. But the second driver of this, frankly, is the shortage of components, meaning we may have 95% of a certain product in inventory to finish a product, but we're missing the other 5%. And so, our inventories are more elevated till we get that missing piece and then we can finalize it and ship it to the customer.

I've gotten often the question, do you now think that you will have to run going forward consistently at higher levels of inventories? And to that, my answer is no, I'm not convinced that that is the case. And the reason I say so is, on the one hand, do I see that there will be more sources of supply, including more local sources of supply

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down the road? I think that's the case. What that also means is there will be less inventory on the water every single time as well.

And so, I'm not yet ready to say that going forward, we will be operating at higher levels of inventory. Frankly, from an overall working capital point of view, as we shared with you at Investor Day, we see opportunities to monetize some of our working capital in the next several years.

Andrew Obin

Analyst, BofA Securities, Inc.

Well, we are out of time. This has been fantastic. Thank you so much. Thank you for coming to London. And thanks to everybody in the audience.

Patrick P. Goris

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

Very good. Thank you for having us here.

Andrew Obin

Analyst, BofA Securities, Inc.

Yeah. Thank you.

Patrick P. Goris

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

Thank you.

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