15-Mar-2023

Carrier Global Corp. (CARR)

J.P. Morgan Industrials Conference

Copyright © 2001-2023 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

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

Sam J. Pearlstein
Vice President-Investor Relations, Carrier Global Corp.

OTHER PARTICIPANTS

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Okay. I think this is the last one of the day at least for me. We're finishing out here with Carrier and CEO, Dave Gitlin; as well as Sam Pearlstein, IR rep. Dave is going to open it up with a few comments and then we'll go right to Q&A. Dave?

David L. Gitlin

Chairman & Chief Executive Officer, Carrier Global Corp.

Steve, thanks so much. Thanks to you and JPMorgan for having us.

Just a reminder of our key three themes. On the top line, we remain confident in consistent and outsized growth driven by our purposeful shift to digitally-enabled life cycle solutions from leaning in to key secular trends, such as being a world leader in the energy transition and, of course, continued pricing. On the bottom line, this year, we get back to basics with driving tenacious and disciplined cost reduction. We track every penny of our cost reduction initiatives and potential inflation headwinds through a digital platform.

So, internally, we have one source of the truth and the team works it daily and the days of covering cost increases only with price are over. We need to keep the price that we've achieved and selectively increase price where appropriate, while we go aggressively at reducing materials and logistics costs, discipline in factory productivity and continuing on our journey of significant G&A reductions. We said $300 million of productivity plus $200 million of price/cost positive this year, and it would not surprise you that we're pushing for higher numbers internally. And despite the challenges, I have confidence in our team to drive the results we expect of ourselves.

And on the balance sheet, we put ourselves in a strong position to play offense with capital deployment. We are working on acquisitions as always and we'll see what happens there, and we remain steadfast in assessing our current portfolio.

Copyright © 2001-2023 FactSet CallStreet, LLC

And then finally on the first quarter, Steve, no new news. We said $0.45 to $0.50. We reviewed that yesterday and again remain in that zone. Orders have improved through the quarter. January was a bit light, but quarter-to-date, we're flat to down a couple of percent versus where we were in terms of orders last year. So, it's nice to see the sequential progress, but of course that can swing week to week, so we'll keep a close eye on it.

And also, just one comment since the issues arose last week in the banking sector have continued into this week. I'll just address it upfront. We have no material exposure to the regional banks or Credit Suisse. If looking for a good news, rates have actually been coming down, which is good for many of our end markets and customers in those markets and potential acquisitions that may or may not happen down the road.

So, with that, Steve, we'll get into the Q&A.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

I don't have exposure to Credit Suisse either...

David L. Gitlin

Chairman & Chief Executive Officer, Carrier Global Corp.

Okay. I can imagine.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

...unless JPMorgan does, [indiscernible] (00:02:48).

David L. Gitlin

Chairman & Chief Executive Officer, Carrier Global Corp.

Yes. No, no, you don't want to get out of your skis, but they're – yeah.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

...discuss at different conference.

Copyright © 2001-2023 FactSet CallStreet, LLC

QUESTION AND ANSWER SECTION

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So, just on the quarter-to-date order trends, maybe if you could talk about anything moving around relative to you were down 10% in the fourth quarter, some bifurcation in businesses, anything within that profile, those that were above and those were below moving around at all quarter to date just to wrap that conversation?

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

A

Yeah. At a high level, as you said, we were down about 10% in the fourth quarter and that's about what we saw in January. But we saw a nice progress in February. We didn't know if it was temporary, but it's continued into March. If anything, March is – the first couple of weeks of March were better than what we saw in February. So, that's put us in a position where I think the precise number quarter-to-date is now 2%. But so, we're kind of in the zone of flat to last year. So, it's nice to see the sequential progress as we've gone through the quarter.

And the markets where we expected more strength is where we've seen better orders. So, Light Commercial has continued to be very strong, Commercial HVAC strong, transport refrigeration especially North American truck/trailer continues to be – we continue to see strength. We actually saw resi orders pick up a little bit more recently. A couple of weeks doesn't make a trend, but we expected weakness there. We saw a couple weeks of some level of strength there in resi. But overall, the areas where we thought we would see strength we have.

And then I would say the two areas of weakness which we saw in January that have continued is our Commercial Refrigeration business in our stationery business in Europe. Orders have been weak there as expected. And in our container business, which is I think 2% to 3% of our sales as a company, container orders have been weak in the first quarter.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So, it sounds like on the resi side, you guided the year I think on a unit basis down mid-to-high single digit. That sounds like it's in tact. Maybe talk about what the feedback has been so far from the channel on the sources of demand. Has that new housing completion dynamic really hit yet? Is it replacement? Is that profile in resi kind of what you would have expected, any changes in the market views there?

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

A

No, it's been consistent. We've seen some of our big homebuilders report results and forecast the rest of the year. And some remain actually more bullish than our own forecast, which is we said that for the full year that we had volume for new home construction for us down 20%. But we've seen some of our key customers a bit more bullish than that. So, that would be positive, if that were correct.

But I would say, really, no new news on the resi side. As you said, for the full year, we said that resi would be flat; volume down mid to high; replacement down mid-single digits, and that would be offset by mix and price. We did announce an unexpected price increase in January. We weren't anticipating that we would do that in January and in November, December, but we felt it was appropriate to do as we got into January. And we've been very

Copyright © 2001-2023 FactSet CallStreet, LLC

encouraged by the realization on the mix side with the new SEER unit and we're very pleased with our new SEER product line. I would tell you that hats off to the technical team because we positioned ourselves for differentiation with the new SEER unit and what the team has also done is anticipated very well the refrigerant change. So, I think we're going to have much fewer changes than some of our peers when it comes into the technical changes for the new refrigerant change.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

And on that front, to get this out of the way, what is it specifically that you guys did that perhaps others aren't doing?

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

Well, we did...

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

Not all others, there are some that...

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

No. No. There are others, yeah. But I think what we did is we invested in a micro channel heat exchanger, we invested more in copper to aluminum, a bit more in the aesthetics, a bit more in just the overall product line that we're very, very pleased with in terms of the attractiveness on both the energy efficiency and the appeal to our dealer and homebuilder and our end consumers. So, and the other thing is it's fully anticipated the low GWP refrigerant, the R-454B that we've designed around. So, it's going to be a much less risky and a much simpler lower cost technical change when it comes time for the refrigerant change.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

This whole debate around useful lives, I mean, you guys said at your – in early 2020 at your Investor Day, you had a guy in the basement who was running all the [indiscernible] (00:07:22), it's 15 years and then it breaks and they make fix it and it goes to...

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

Yeah.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

...17 useful life. Is that guy still around and what is he saying?

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

I don't know. He doesn't come up for air. So, I never met him. Yeah.

Copyright © 2001-2023 FactSet CallStreet, LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

What is he saying today? Like what's changed that useful lives seem like there're − the data would imply the useful lives are shorter?

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

A

Yeah. We used to − when we spun from UTC in 2020, we were talking about a 17.5 year useful life and now we've been talking more like 15 years. Part of it is this whole work-from-home thing that the units are running more during the course of the day. So, we look at warranty data, we do surveys of many of our customers and I don't want to pretend it's a perfect algorithm, but the data would suggest that it's a shorter useful life for a bunch of those factors of people moving south, the units running hotter, running longer, would suggest it's closer to 15 days and our data suggest that as well.

Sam J. Pearlstein
Vice President-Investor Relations, Carrier Global Corp.

A

Years?

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

A

Years. Did I say days?

Sam J. Pearlstein
Vice President-Investor Relations, Carrier Global Corp.

A

Yeah.

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

A

That'd be nice.

Sam J. Pearlstein
Vice President-Investor Relations, Carrier Global Corp.

A

Thank you for the next bull case, though. That's the next bull case.

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

A

Yeah.

Sam J. Pearlstein
Vice President-Investor Relations, Carrier Global Corp.

A

It's 15 days.

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

A

Yeah. I'd like to get our warranty to 15 days. No. So – no, 15 years. Thank you, Sam for...

Copyright © 2001-2023 FactSet CallStreet, LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

It's been a long day. When you think about the refrigerant transition, just one last one on that, do you expect to pre-buy on that product in 2024?

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

A

Yes. We do because it was a little bit unique with the SEER introduction for this year because, of course, you had in the south date of manufacture. So that kind of skewed the whole pre-buy at the end of last year but I think as we get into the end of 2024, we would expect some level of pre-buy prior to 2025 because we know that we will be pricing that unit, of course, higher as we get into 2025.

And I think, look, we get – and maybe Steve, I'm getting in front of a potential question you would ask, but in terms of destocking out in the field, I think if you look at it, you look at where we are in the cycle, right now at this point in the year, usually the channel starts building up in anticipation of the season. So, if you were to see a level of destocking, you'd see it sort of towards the end of this year into early next year. But then as you start to restock for next summer and then you'd have a restocking at the end of 2024 in anticipation of 2025. So, could there be some level of destocking this year? Yes. But what we have said is that if we were to see destocking, think about our profit, over $3 billion, call it $3.1 billion or so, that if we were to go back to the stocking levels of 2019, that would impact us by less than 1% of our total operating profit. So call it around $30 million. So this whole destocking discussion, which takes up a lot of oxygen and a lot of discussions, doesn't keep us up at night.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right. And that's on the resi, the resi side...

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

A

Resi side. Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

...on inventories to make that clear. How big is the heat pumps for you? And I think the heat pump conversation kind of gets a bit far flung because there's ductless which kind of count as heat pumps and there's ducted heat pumps and there's hybrid. And as heat pumps get kind of like lumped in, how big is heat pumps for you? And maybe how do you guys map the market and the opportunity set is the IRA money starts to come through next year?

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

A

We love our heat pump position. We've said that we're about $2 billion, but that excludes VRF. To your point, there's a lot of people reporting what their total heat pump sales are and there's a lot of stuff in and out of that. And VRF is our heat pumps. So, we just bought Toshiba, they have a couple of billion of sales. So not all of that is heat pumps, but a good chunk of that. So our heat pump position including VRF is well over $2 billion.

Copyright © 2001-2023 FactSet CallStreet, LLC

And then, we look at the growth that we've been seeing. We're very well positioned in the United States because we're clearly the market leader in the residential space. So, we go the way of the overall market and heat pumps orders were up 30% last year, North American residential, they were up a similar number in European commercial where we're number one. So we're very pleased with our position globally on heat pumps. And I think there's no question that's going to continue to grow exponentially.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And then one last one just on pricing in resi, you guys do another price increase. What's your take on the – should the yield on that be a little more normal? Obviously, the yields in the last couple of years have been ridiculously high on very significant price increases. Any changes in the view on the yields on that price increase this year may be more normal or...

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

It's hard to say just yet. I think that, as you said, the yields that we've gotten – we've had six, seven price increases over the course of the last 18 to 20 months. And the yield on those have been extremely high. So we'll have to see what the realization rate is on the most recent one. And my – if I had to guess, it would be somewhere between the levels we've been seeing recently and perhaps the more typical levels we would have seen before.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And directionally, on your resi, if you're going to be kind of flattish on revenue in resi, can your margins – what are your margins do this year, just up or down or flat, like you would expect to improve margins on that flat revenue?

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

Yeah. I think margins will be flattish in resi. I think that it's one of our higher margin businesses. And that team has done a phenomenal job even with the – just the mathematical head when you get from price/cost. Being what it is, they've done a very good job at sustaining margins.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Got it. On the commercial side, pretty strong demand. Maybe just talk about first light commercial, what you're seeing there, and the context of that, how supply constraints are playing out? There were some – we were hearing from the channel, maybe not you guys where there were 50-week lead times. Where are those today, and then just how is demand generally trending in light commercial?

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

Demand has been phenomenal in light commercial. Our biggest challenge is keeping up with the demand in light commercial. And demand that we saw last year that was great has continued into the first quarter this year. So I can tell you without any question, we've picked up significant share in the light commercial. We picked it up the right way by introducing new products that are 40% more energy efficient than the products they replaced through customer intimacy, and really gaining share through all the right ways to gain share. We said that this year would

Copyright © 2001-2023 FactSet CallStreet, LLC

be up mid-teens. We're certainly well-positioned for that and first quarter is looking very strong for light commercial.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

And your lead times now and where are the constraints? My guess is chips and boards and all that...

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

Yeah. It's some of that. Our lead times are certainly not at the 50-week level, they're less than that, but they're higher than what they traditionally would have been. And I could tell you that when I think about light commercial but more broadly supply chain, we are in a far better position today than we were six months ago. I could tell you that last year was unlike anything that I've ever seen in my career because of just the magnitude of the number of issues and the frequency with which they were occurring. So, we really put our operations and supply chain team through so much last year just to keep up with the surprises.

This year, we are not back to normal. We still have a certain number of acute suppliers that are impacting us, but far fewer surprises and we're much more calibrated on the chip situation. The lead times for chips are still way higher than they historically would have been, but now we're more attuned to that. We've redesigned more than half of our critical integrated circuits so we can better manage some level of redundancy on the chip side. And again, we're down to some key suppliers that are causing us a fair amount of pain, but we know who they are and we're making progress with them.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

The price/mix split of that 15%, is it roughly 50/50?

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

Did we break out?

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

We didn't break it out. In part, you have the same challenge with this year change in terms of what's price and...

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

Yeah.

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

...what's mix, that it's – it's harder to do that, but there is volume growth in that assumption.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

Just maybe a little less than resi, is that fair?

Copyright © 2001-2023 FactSet CallStreet, LLC

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

Well, resi is going to be down in volume this year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right, right, but I mean it's...

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

Like similar.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Like a price capture versus resi?

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

Yeah, it's probably in the same ballpark.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. That helps. And it's about $1.5 billion of that business, the light commercial business?

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

We haven't shared that.

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

You always do this, Steve. You always like, you always find ways to get information out of people of – yeah, it's enough.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

That's part of our job.

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

It's a great business, though. I will tell you that the – I mean, like, it's – that's you're kind of in the zone, but what I will tell you is, there're certain businesses that are in a moment of time where they're really clicking on all cylinders. And my hat's off to that team because it's gaining share, it's improving price, it's improving margins, it's taking costs out of the system, it's introducing new products, it's dealing with some real scale customers that historically would have been with a competitor that had moved over to us. So we're very pleased with our light commercial situation.

Copyright © 2001-2023 FactSet CallStreet, LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And when you think about the pie chart on the light commercial industry, maybe what are some of the end markets that are blowing and going for you guys? And then – but maybe one or two that – doesn't sound like there are many, but one or two where you're seeing a little more risk?

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

A

Well, we like K through 12 just very strong. A reminder that the ESSER funding from the federal government did allocate $190 billion and there's still $120 billion or so yet to be allocated. And a lot of that, which is called this ESSER III, this last phase of the funding allocation is towards more of the bigger projects, which plays right to our strengths. So there's a lot of funding available for K through 12 and we have a very targeted approach for that space. Higher-ed has been very strong as well, it's not just K through 12.

Many parts of health care remain strong. Quick-serve restaurants have been doing well. Some of the discount retail has been very strong. So there's a lot of – maybe warehouse had been huge pocket – huge source of strength that's slowed a little bit, not that it's down significantly but not as strong as it was.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Where are we cyclically on that market? I mean, the units are not back to peak. Sounds great. Is there any risk as maybe the office markets roll-over, anything like that? I mean, anything you see fundamentally out there that you'd be concerned about?

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

A

Not yet. I mean, I'll tell you that the light commercial, all the indicators have been strong. They've been strong now for a couple of years and we haven't seen any sources of weakness that would indicate there're some kind of pending downturn there.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. On the applied side, you guys have really invested over the last couple of years, reestablished yourself maybe not to the point that you would have expected on from the market share perspectives we were discussing a little bit earlier. What's the story in your applied business? And then maybe compare that to the demand picture there versus what you were just talking about in light commercial.

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

A

Demand is great. We've gone through eight quarters of double-digit orders growth in the commercial applied business. So, I would say overall demand great. The services piece has been transformational because one of the biggest shifts across Carrier has been a very purposeful shift to not only winning on the upfront equipment side by having a differentiated product, but also making sure that we support the customer through the lifecycle. And that has been, I would say, if you were going to say what is the biggest change that you've seen at Carrier over these last few years that will continue is really smoothing some of the cycles through a very conscious effort

Copyright © 2001-2023 FactSet CallStreet, LLC

towards recurring revenues, aftermarket lifecycle sales and we've seen great progress across the Carrier portfolio and particularly in commercial applied HVAC space.

I would say on the share side that we had said at our Investor Day that we expected to grow 50 bps a year. The reason that we have not done that is by our own decisions that we have made decisions to win what we want to win, win the right things and we have walked away from certain business because that's an area of the business that we really needed to and wanted to improve margins. And Chris and [ph] Garang (00:19:58) and the team have done a phenomenal job at improving margins in that business. So we've kind of prioritized that over the 50 bps a year. But in the middle of that, we have gained share for sure.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And when we think about the margin profile of those business, I've always thought of it as resi, light commercial and then the applied stuff obviously, it's a bit more project related. You go into a conference room, you compete with three other guys. So is that still kind of the profile where light commercial and resi are pretty similar and then applied is pretty materially below?

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

A

Yes. But I will say that the applied margins have been improving materially in part because of – that as we've introduced new products that we find in many cases are differentiated and as we've really leaned into making sure that we have the pricing discipline, we've also really emphasized the aftermarket piece, which comes with higher margins. So that mix has been very favorable on the margin side and there's a long way to go. But we set targets for ourselves on the margin side a few years ago and every year we've been on track to the margin profile we've set for ourselves.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So how do you compete with to JCI's and your credit, years ago, they were really focused on service. Obviously, their larger engineered products kind of lend themselves to more of a service but they have like a pretty comprehensive stack if you will, including the control systems. They're all over the building. I mean, they have 14,000, 15,000 service techs. How do you compete with that? And you have I think 700 or so service locations but how does your service tech infrastructure compare to that? And how do you compete with such a – with the scale there?

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

A

Well, we have a couple of key competitors. And I'll tell you, we compete extremely well with them that there's no material gaps in any of our respective portfolios, there's probably a niche area in one specific application and one region of the world where someone may have a better offering than we do. And I can assure you, there's many parts of the world where we have far better offerings. So we're very pleased with our position. The number of technicians we have, I can tell you that we continue to add salespeople and technicians, but the way of the – the way of supporting of the equipment is becoming more digitized as well.

So as you have more connected devices where you can do more remote diagnostics and more remote prognosticate to anticipate failures, you're not just competing on the person with the most technicians wins. So we're very, very pleased with the aftermarket progress that our commercial HVAC team is doing. And I could tell

Copyright © 2001-2023 FactSet CallStreet, LLC

you that in critical areas like heat pumps and data centers, we've been picking up very significant share and very targeted share.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Can you just talk about Abound a bit? And what that is and any KPIs that you're looking at to judge the progress?

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

A

Yes. One of the biggest decisions that we made as a company is that for our two ecosystems of focus, which is buildings and the cold chain, we wanted a digital platform for both. So for buildings, it's called Abound. And we designed that very purposefully to make it agnostic so it can interface with anyone's BMS. There are some of our competitors that have a similar offering. We're all cloud based, but they purposely made it so it was more proprietary and only interface with their own building management system. We wanted to make it so it could overlay, it was cheap and easy and quick to install in a building like this. It would interface with anyone's BMS and then it's all outcome based for our customers.

So if you can picture that, in the past Carrier would have been sitting across the table from – if one of the most the biggest retailers in the world, we would be with the head of facilities for the southeast region of the United States. We're now sitting across the table from CEOs telling them that we can make a material difference for them to get to their own ESG commitments and we can drive them huge amounts of savings on energy efficiency and help them get to sustainability targets.

The way we do that is implement this digital tool across their entire footprint that on a single pane of glass can give them visibility into their carbon emissions. And if there is an issue where, say their factories in India have higher carbon emissions than their factories in China, we can now use AI to take corrective action. It may be that we have a new energy efficient rooftop unit. It may be that we have the equipment and the solutions to help correct it.

We have an eco-energy business where we partner with folks like Home Depot, where we guarantee them certain energy efficiency savings for their North American footprint, where we are rolling that out to our scaled customers globally and Abound is a key enabler. Once we have the platform, then you're continuously producing new applications. We have an application for indoor air quality. We have an application for net zero emissions. We have apps for prognostic diagnostics. So, it's just once you have the platform and you're in your customers' ecosystems, you keep introducing new applications on top of it.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

How do we think about the – you mentioned that applied margins were improving because of the services mix. Where does the service margin lie in that profile in that continuum of those different [indiscernible] (00:25:25)?

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

A

Well, we've said that at a high level, the services margin for all of Carrier is 10 percentage points higher than the rest of Carrier. So clearly...

Copyright © 2001-2023 FactSet CallStreet, LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

That's a gross margin kind of...

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

A

Yeah. Gross margin. Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. But there is more SG&A in the services on...

Sam J. Pearlstein
Vice President-Investor Relations, Carrier Global Corp.

A

In parts of the service.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah. Okay. Got it. On refrigeration, obviously you talked about the container business. How is transport looking from an orders and outlook perspective? Trane called for it to be down next year. You guys haven't really said anything on 2024. Maybe just an update on transport first.

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

A

We're very pleased with transport and the truck/trailer side, both – not only in North America, but we're also seeing in Europe and certainly in China. I have to give credit to our team in China where we've picked up just enormous share. A smaller market, but a growing market as you see China go towards more end-to-end cold chain solutions, selling less food through local markets, but selling them through traditional supermarkets.

So the opportunity for cold chain growth in China is significant and we have extremely good share and growing share. North America, we're extremely well booked for the foreseeable future and orders continue to be strong. So very well positioned in North America, both on the truck and the trailer side. The orders in Europe for truck trailer were a little bit lighter than what we saw in North America but still our backlog there is extremely strong as we get through these coming quarters.

So it's a bit early to get into 2024. I saw what perhaps our peers said about next year, but I will tell you that ACT and others I think under forecast for 2023 looks like, and when I look at our backlog position for 2023, it would not take a lot of significant orders in the second half of this year to start positioning as well for 2024. So we'll have to see as we get into 2024 but very pleased with our situation for 2023.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Is there a particular fundamental reason why you think ACT? Because I think they're calling for it to be down in 2024 in North America. Is there a particular fundamental reason why, if they revise that up by 10%, what do you think the fundamental reason for that would be?

Copyright © 2001-2023 FactSet CallStreet, LLC

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

I mean, look, the industry is just very attractive right now. You have a couple of things happening. Number one is that one of the nice things about our portfolio right now is, you see the shift to electrification, you're seeing significant mix up. So we mix up when you go from diesel refri units to electric units, that will be a significant mix up story for us. But we see the same as you go from traditional as you shift over to heat pumps, that's a great mix up story for us.

It's a very attractive piece of what we see in the European residential heating space where we're a very small player but that makes that industry very attractive both organically and potentially inorganically. But back to the transport side, we're seeing just continued demand for transport fleets. We're seeing more demand for our [indiscernible] (00:28:40) platform, which is the same as what we describe for Abound for buildings. We're seeing more subscription revenues as we have more digital sales to our transport customers as well. So teams performing well on the truck/trailer side.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And then just on the refrigeration piece, the stationary side, what are you seeing there? And then maybe what's your view on improve versus perhaps sell that commercial refrigeration business? I think that's been a continuous conversation over the last several years. Where do we stand on that today?

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

Well, we're still in the improve phase and we continue to assess not only that business but we've been consistent that we will forever, we will assess every aspect of our portfolio very clinically and very dispassionately. And that's certainly on the list of something that we would access. It does have lover margins, but right now we're in the self-help phase of really improving the margins of that business and the team has done a lot. They did a lot in 2022 to position us for higher margins in 2023. We took a whole lot of G&A out. We went from each country having its own infrastructure in Europe towards a more regional approach. We've been very deliberate at decreasing the amount of customization of the product line, improving the aftermarket margins, pricing the upfront sales appropriately to get the margins up.

So we were poised for the margin growth this year and then we came into this year with orders much lower than we thought. So now we're scrambling dealing with some level of cost-takeout because the factories are dealing with some absorption issues. But I think that, as we look at it, we see really strong opportunity for margin expansion and then we'll assess as we always will, whether we keep it and continue to improve margins or divest it.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And is that a change at all from what you would have thought maybe 9 months, 12 months ago or is this just kind of a continuum of analysis around keep or sell?

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

Continuum.

Copyright © 2001-2023 FactSet CallStreet, LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. Got it. And then on that − continuing along that, Fire & Security, what are you guys seeing there? And obviously a better margin business, run pretty well. What are the synergies there with the rest of the portfolio? And is that something that you could ultimately look to monetize at some stage of the game?

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

A

Like the rest of our portfolio, we'll look at everything. And the question we have to ask ourselves is does the benefit of the revenue synergies, whether it being part of the portfolio outweigh the benefit we would get from somehow divesting it and reapplying that for a more focused company? And that's an analysis that we've been doing since we spun and will continue to do forever. There's a lot to like about the Fire & Security portfolio, very high margins, a lot of differentiation. In many cases, there's only a few of us competing and we have some great technology. We have a great team. We have a very attractive footprint. We have a very low cost, both make and buy footprint.

So there's some great parts of that business but there is value to focus. We saw with the spin from United Technologies that I think we unleashed a lot of energy and value within Carrier when we became a standalone public company. I think Greg saw that opportunity and did the right thing, and that's an assessment that we will continue to make as a team. But in the meantime, we'll continue to improve the margins of Fire & Security and we'll continue to invest in that portfolio because it's a great collection of businesses.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And how does it work with the commercial HVAC stuff? I mean, is there any – JCI talks about obviously the integrated offering, how much is the integrated offering present there or are they seem like a little bit more discrete businesses?

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

A

They are discrete. There's certain technical synergies between if you think about a security system, it tells you where everyone is in the building. Knowing where people are in the building can play into how you think about ventilating for certain parts of the building. There's an interconnectivity between a fire and the fire system and how you might think about shutting off certain ventilation or airflow into parts of the building that might be on fire.

So there's sort of inherent natural technical synergies between the HVAC and the Fire & Security portfolio. And you do typically have different channels, you typically have different decision makers within the building on which systems. So to really realize some of those synergies, there's some complexity there. But having said that, again, a great set of businesses and we have made a very deliberate decision that we want to be the world leader in climate systems and solutions.

There's a huge energy transition, there's a shift towards electrification and more renewable type solutions. And we want to position ourselves right in the epicenter of being the world leader in some of the building climate systems and solutions capabilities. Fire & Security, great set of businesses. And we'll continue to assess that. And in the meantime, Jurgen and the team are doing a superb job really improving the margins and capabilities of that business.

Copyright © 2001-2023 FactSet CallStreet, LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

I want to step back to one business in commercial HVAC, Europe HVAC. And maybe this is where you talk about a bit of – if you did have capital to deploy into something strategic. You've mentioned this could be an area of interest. But first of all, in commercial HVAC in Europe, how are you positioned there? Trane makes a lot of noise about how they're dominating there, and JCI has some products as well. How are you positioned first on the commercial side? And then how would you like to attack that market if you could deploy some capital there?

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

A

I'll tell you, last week I was with Didier and the team and – the person that runs our commercial HVAC business in Europe, and was with him and the team in France. And I could not be more proud of that team. They've done phenomenal job in the factory. They've done a phenomenal job with the product portfolio getting out in front of all the transitions that are taking place. As you look at the need for heat pumps, especially in areas as you look at heat recapture and reuse in data centers.

So we look at an entire product portfolio mapping of every single area where there's demand, and do we have the right offering, and do we have a competitive advantage? We've picked up a lot of share in the European commercial HVAC space. And then we look at getting out in front of some of the refrigerant changes that are going to happen as they – that Europe is assessing F-gas and natural refrigerants. And we choose between propane for certain applications or ammonia or CO2. The interconnectivity between the technical team and the marketing team and the sales team and the production team is about as good as it gets, so very proud of the share and the performance of our European commercial HVAC team.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And when you think about capital deployment, if you did bring in cash from a divestiture or even just levered the balance sheet a little bit, is Europe a place where you would want to focus?

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

A

Yeah. Europe is extremely attractive in the sense that the residential heating space for Europe is one of the most attractive spaces in the HVACR industry in the world. When we spun, we had two big gaps. We had VRF, which we now address with the Toshiba acquisition and we're not a major player in the residential space in Europe. We have a small Italian business that does a nice job, but the truth is it's very small. It's relatively a small player in overall Europe.

So what's going to happen in Europe is that as Europe weans itself off natural gas, especially with what's going on in Russia and they have traditionally gotten 50% of their natural gas from Russia, as they reduce that in a significant way, you're going to see a tremendous transition to heat pumps and heat pumps sell for 3x to 4x what you would sell a wall-hung boiler. So, a significant transition with a huge mix-up, so that market under any scenario has to grow, has to grow significantly and we're looking to grow our position organically in that space using more of our Toshiba and our Chinese acquisition Giwee to sell more product in there, expands some of the [ph] Rialto (00:36:57) capabilities that we have with our Italian operations and it's clearly an attractive area from an M&A area. It just happens to be very difficult to break into.

Copyright © 2001-2023 FactSet CallStreet, LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Any questions out there? No, none.

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

A

Yeah. My guess is you have more. Yeah, you could go. Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

I have more. The margins, it appears that your price is really seems to be carryover from last year, but you guys put through a price increase in Jan 1 on resi, a price increase in March in commercial I think. Are you assuming lower yields on that front or it's sometimes the math is hard to do with carryover, but what are you assuming on a yield basis from the pricing in general?

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

A

Well, we said that we would be price/cost positive by a couple of hundred million dollars. So I do think that the carryover math is a little bit more complex than when some people say I should get – whatever you did in the first quarter of last year, I should get a certain like at least one quarter of that this year. There's actually a little bit more to doing the price carryover analysis. But having said all that, we feel good about the price position. We announced a little bit more in January. We're going to have to see how inflation plays out.

We'll look at the commodities. Copper came into the year a little bit higher, then it came down a bit. So we did more than we planned to do in January. If we have to do more as we go through the year, we will. But the realization last year, I mean, you think about getting over $1.5 billion of price on say $20 billion. So call it 7.5% realization. I don't see those rates of realization continuing, but I do think we'll get meaningful price and meaningful realization this year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And then on the inflation side, I mean, you mentioned these metals are bouncing around a little bit. How do you feel like today relative to maybe how you felt a couple of months ago about the cost inflation?

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

A

Well, I think I feel better at overall our ability to go meaningfully attack the cost equation because the reality is last year was very, very tough on the cost side. We experienced about $1.5 billion of cost headwind. And I have said and apparently it offends people, so I apologize, but it's our God given right to go get that cost back because you look at $1.5 billion last year, $0.5 billion before, now we have a single tool where we track every ounce. If a supplier says they have to increase, it goes in the tool and we have all kinds of approvals before we grant it. We're going hard after the Tier 1 suppliers. Commodities, I think, are coming down. Logistics is an enormous opportunity this year, and I think we've just scratched the surface of logistics. Our plant managers need to get back to basics and driving productivity in the factories every day. G&A, we've gone from 9.5% to 7% of sales and we've just gotten started. There's a lot more G&A take-out. So, look, we said $300 million of productivity this year, I can assure you we're pushing the team on more.

Copyright © 2001-2023 FactSet CallStreet, LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And then longer-term incremental margins, I mean, just remind us of how you guys look at that. And should we think about taking it over a multiyear period, normalizing it and then thinking about some catch up on the back end of that...

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

A

Well, we've said...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

...in order to normalize?

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

A

...we've said 50 bps a year, like this year we have a little bit of headwind because of the Toshiba integration. So if it weren't for that, we'd be at 50 bps this year. But we've said 50 bps a year, we'll continue to invest in the business. Part of our algorithm for this year assumes another $100 million of R&D. We were at $400 million of R&D in 2019. Last year was $540 million, so we continue and that's more than a 10% CAGR increase on R&D as we continue to take share and invest in the portfolio. So we'll be brutally aggressive on the cost side in a very structured way and we'll be very selective and thoughtful on investments to increase the top line.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

One more for you, would you manage that 50 bps and if you were doing 60 bps, 70 bps to reinvest and maybe go after some market share?

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

A

No, we don't necessarily sell for 50 bps. So there may be some years where it's more than 50 bps. We invest where we think it makes sense, where we can really make sure that we have the right payback. And if some years it's higher than 50 bps, that's certainly a fine thing.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Great. Okay. Thanks a lot.

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

Thank you.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Copyright © 2001-2023 FactSet CallStreet, LLC

Really appreciate it.

David L. Gitlin

Chairman & Chief Executive Officer, Carrier Global Corp.

I appreciate it, man.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Thank you, sir.

David L. Gitlin

Chairman & Chief Executive Officer, Carrier Global Corp.

Yeah.

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2023 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.