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Carrier Global Corp. (CARR)

Bank of America Global Industrials Conference

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CORPORATE PARTICIPANTS

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

OTHER PARTICIPANTS

Andrew Obin
Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

[Abrupt Start]

Andrew Obin
Analyst, BofA Securities, Inc.

...just introduce you, Patrick. Thanks so much. We continue with our sessions. And with us, we have Carrier. And with us we have Patrick Goris, Senior Vice President and the company's CFO. I think Patrick will make a couple of comments with slides. And then, we'll go to the formal fireside chat. Thank you.

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

Excellent. Thank you, Andrew. Good morning, everyone. Our story is a lot more exciting than the music we just were listening to. So, Carrier, you may have heard of Carrier. We've been in business for over 100 years, but we've been an independent public company for only 3 years, actually less than 3 years. So, I thought I'd provide you an overview of our company and so you can learn more about our exciting story.

At the end of the day, we think we are a very attractive investment opportunity and to understand that there are some five key elements here. One, we have iconic brands and leading market positions in a very attractive industry and in end markets with important secular drivers. And I'll talk more about that. But on top of that, there are some Carrier-specific elements that we think make our investment thesis even more attractive.

One, we are underrepresented in our own aftermarket, so we have an outsized opportunity to grow in high margin, high growth aftermarket. Two, we have a significant opportunity to simplify our company and take cost out. We've done a lot of that already. There is a lot more to come. And then, three, we've done some work already on simplifying our portfolio, but again, there is more work there to be done. We have significant capital available for value-add capital deployment.

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So, let me first provide a brief overview of our company. At the end of the day, we are a global leader in healthy, safe, sustainable, intelligent building and cold chain solutions. We're a very global company. We compete on technology differentiation, and we invest in digital platforms such as Abound and Lynx to drive more customer intimacy, more recurring revenue. And of course, this is a key enabler for aftermarket revenue growth.

You also see there that we are focused on ESG excellence. We help companies achieve their carbon reduction or carbon emission reduction goals. And so, we are really an important player in helping our customers achieve their objectives and drive more sustainability and efficiency in everything they do. So, organized in three segments, each one of these segments, as you can see on the slide, has leading positions in each market that it operates in. So, all three segments are global and all three segments are really focused on important things.

In HVAC, of course, we help with the quality of life of many people, the indoor air quality, indoor comfort. Fire & Security speaks for itself, keep people in buildings and individuals safe and secure. And then, of course, in refrigeration, we ensure that medicine and foods get transported in the best way possible, meaning reducing waste. And across those three segments, a key element on reducing energy consumption. So, increasing efficiency and, of course, a big opportunity in driving aftermarket growth. And I'll touch on that in a little bit.

So, about a year ago, we had a Investor Day, and we laid out our value creation framework. And it's the same that you see here. We're focused on above market organic revenue growth. We have different levers available for margin expansion. Aftermarket is just one of them. We will talk about productivity as well. We are continuously looking to drive more tax efficiency, deliver strong free cash flow and then reinvest our capital into higher growth opportunities. And the outcome of this is what you see on the bottom line. We expect double-digit EPS growth through the cycle. In the last few years, we've actually done pretty well following this model.

I talked to you that we have some secular tailwinds that are really attractive to our business, and I would expect that you recognize the ones you see on the top of this page and each one of these benefit our business. So, you see healthy indoor environments, the move towards electrification, a huge tailwind for our HVAC business, but also our transport refrigeration business and anything digital enhances our capability to provide aftermarket service and more sticky recurring revenue streams.

What is not on the slide but is in the takeaways, is that more recently, whether it's in the US or in Western Europe, there has been a tremendous increase in government incentives or regulations to drive more adoption on some of our technologies. For example, the Inflation Reduction Act in the US, some of the incentives available in Western Europe towards the – move towards more heat pumps. It really turbocharges some of the secular tailwinds you see at the top of the page and we're really well positioned to benefit from that.

Let me talk a little bit about aftermarket. We estimate that our current aftermarket business is about $5 billion. So, it's about a quarters of our business. But we believe that the annual revenue available with our installed base globally is about 4x or 5x our current aftermarket business. In other words, we're significantly under-represented in our own aftermarket. We had a late start. Our CEO, our aftermarket leader, they both come from the aerospace business where they make all their money on aftermarket. So, in the last few years, we've had a tremendous focus on aftermarket. Since then, our aftermarket business has grown by double digits.

Why do we like this? At the end of the day, it's our equipment. So, we are the OEM. They're our customers. The aftermarket business on average has gross margins over 10 points higher than the company average. There is – and there is a high level of recurring revenue streams associated with this, increases customer intimacy, increases customer loyalty, increase more – increases the level of pull we get from customers for our equipment.

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So, only good news on aftermarket and it's probably the number one internal focus we have from a commercial viewpoint across all of our businesses given the enormous installed base we have across all our businesses globally. We talk a little about productivity. I mentioned that we have a tremendous opportunity to continue to simplify our company. By whichever metric, I would look like – look at internally, whether it's number of systems, number of vendors, number of legal entities, we are complex and we are reducing that complexity to drive our cost.

We target every year to take out 2%, 3% of our cost base. We've done that last year. We took out $300 million. We will again take out $300 million this year. This will go on forever. And of course, in our operations, we target a lot more than 2%, 3%. In our plants, it's typically 5% or more through the implementation of automation and other technologies.

Our focus on productivity gets translated into our P&L. Actually, of all our peers, we had the largest margin expansion in our operating margin last year. And so, a big focus there, continued opportunity for many years to come.

Let me talk a little bit about portfolio and capital deployment. It's another element that I mentioned that I think is Carrier specific. Since the spin in April 2020, we made significant efforts in simplifying our portfolio. We sold non-core assets, our stake in Beijer. We sold Chubb, reduced the number of joint ventures. All of that helps us with more focus, reducing complexity. And we made some acquisitions as well that were very strategic and right in the middle of what we're focused on as a company.

We're not done with our portfolio work, and so that assessment is continuing. And I will also say it is across the different segments of the company where we see opportunities to continue to look at our portfolio and see [ph] what are the (00:08:47) opportunities to further improve our portfolio? I would also say [ph] though while (00:08:53) portfolio work continues, we expect to be a net buyer, not a net seller of assets.

Our work on portfolio and strong free cash flow generation has significantly improved our financial position since the spin. One of the prices of liberty or freedom we had to pay was we got quite a little bit of debt from our former parent. We have significantly reduced that as you can see that on the slide. At the same time, we have significantly increased our returns to shareowners, and we have all the capability now to continue to do so. We have about $3 billion, $3.5 billion of cash on the balance sheet.

In terms of capital deployment, you see some of the M&A priorities on the right side. You'll recognize it's very much focused on sustainability, adjacencies, geographic expansion, and anything that can help us accelerate our aftermarket revenues. Capital deployments are pretty clear and are not changing. The best returns we can deliver is by growing faster organically. Aftermarket is just one of the opportunities we have there. I'm sure we'll talk a little bit more about heat pumps.

I talk just about our priorities for inorganic growth today. Paying down debt is not a priority for Carrier. We continue to focus on being a solid investment-grade company and that is exactly where we are today. So, after funding inorganic growth, it's all about shareowner returns. And we have the capability to do both dividends and share repurchases, as we did last year.

So, I mentioned earlier how important of a player we are for our customers in driving their sustainability goals. And so, many companies that you follow have made commitments for greenhouse gas reduction. Typically, they cannot achieve those commitments without investing in some HVAC equipment or depending on the industry, of course, in electrifying some of their fleets. And that is exactly where we come in.

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And we are recognized by many third party leading organizations as being a key player and a key beneficiary of the trend towards more sustainability in the world. And, of course, the more efficient the equipment that we sell, the more costly that equipment is. Which means it's only good news from a financial perspective for Carrier as a company.

Finally, a quick recap of the key messages this morning. Iconic brands, leading market positions, we play in a really attractive market. There are some long-term secular tailwinds we expect to benefit from – for a long period of time. The aftermarket is a key opportunity for us. We are investing in digital platforms as a key enabler for that, driving more asset-light recurring revenues. I mentioned about productivity and simplification, not just from a cost basis but also from a portfolio basis. And of course, significant flexibility from a capital deployment, and I shared with your our priorities there.

So with that, I will turn it over to you, Andrew.

QUESTION AND ANSWER SECTION

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Okay. Patrick, [ph] Sam (00:12:16), thanks so much for being here, always a pleasure.

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

A

Good to be here.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah. So, maybe we can start with the resi HVAC cycle. We have your friends from Florida here as well in one of the rooms. So, they say interesting stuff. But maybe, [ph] big debate (00:12:36), how has demand held up so far in the first few months of 2023? Maybe that's a good place to start?

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

A

By resi you mean resi HVAC, Andrew?

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah. Resi HVAC, yeah.

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

A

Yeah. The question comes up quite a lot...

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Andrew Obin
Analyst, BofA Securities, Inc.

Q

We can talk, first of all resi Fire & Security, but that's probably less exciting.

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

A

Yeah. First of all, residential HVAC is really good business. We have a leading position in the US in residential HVAC. I mentioned earlier the move towards more sustainability, that translates as well into residential HVAC. We believe we have the leading position in heat pumps in the US. We're seeing very strong growth there. And so again, move towards more sustainability will only benefit from that, including in our largest market.

So, we've had some really good years in residential HVAC. For this year, what we expect the sort of residential HVAC sales to be about flattish compared to last year. Underlying that is volumes being down, but that volumes being down offset with price. And then, the impact of the mix up because as people move towards more efficient units, whether it's regulation driven or whether it's people being focused more on efficiency, basically it means higher priced units. And so, full year, we expect sales to be flat with volumes down, offset by the mix up effect and price. For Q1, what we expect is our sales to be down high-single digits in residential HVAC with volumes down in the teens.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah.

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

A

And, again, part of that offset with the impact of price and mix. And as the year progresses, we expect that, that will improve. And so, the second half of the year, we actually expect low single-digit growth in residential HVAC. So, that's what, of course, when the comps will become more easier in Q1. We have a quite a difficult comp one year ago. Residential HVAC sales were up well over 20%, clearly industry leading. And so, we'll have that. And then from there on, we expect to get better on the resi HVAC side.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

So, I'll ask about the question because I think the – sequentially, the comps during the year could be weird. I'll ask that question. But just maybe you on the 2022, you sort of commented that you ended up with more channel inventory level that you were planning. Where are we, I guess...

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

A

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

...since March, what has happened so far? And do you anticipate any destocking in the...

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

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

...spring selling season?

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

And so, what we're referring to is the inventory held in the field. So, by some of our partners of our products, the 2022 ended higher than we intended. And we expect therefore this year to be some destocking and we expect that to particularly happen in the second half of the year. First half of the year, typically, people actually increase inventory levels in preparation for the season.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Yeah.

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

The season in North America. They would expect inventory levels then to reduce by the end of the year, which is embedded in our guidance. So, I don't expect big movements downwards till the second half of the year [indiscernible] (00:15:47) inventory.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And I think it was back in December when you talked to distributors. There was a concern about this air pocket, maybe March, April in terms of production. And it's just seems talking to folks in the channel, those have dissipated. It's just sort of right – there was – there was a fear that those – March, April production volumes, those big question mark, [ph] talking (00:16:10) about discounting, what we're hearing is that, that actually may be getting better, right, at AHR Expo. And Atlanta people, I think were quite constructive. I think some of the distributors we talked to are being more constructive. Can you just comment how that played out?

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

Yeah. The only thing I will say is we don't talk about discounting internally.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

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And so, there is certainly not a discussion around it. And I think that generally the situation is similar to what you just described.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah.

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

A

So, we're certainly not expecting in an air pocket that you referred to was being discussed.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

No. It clearly didn't – it did not happen. Yeah. And maybe we can talk about – so, yeah, so the sell-in, right? And maybe we can talk about sell-in and sell-through. But actually from the channel perspective on the sell-through, is it – if you play – if you go through the math like third quarter there is a [ph] scenario under (00:17:09) third quarter sell-through in terms of units could actually be flat to positive, right? Is that the right way – how should we think about sell-in progressing through the year versus sell-through in the channel?

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

A

I will look at my expert here.

A

Yeah. I don't know whether it necessarily does that for Q3.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yes.

A

Clearly, we call that the movement to sell out and that was down in the fourth quarter.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

A

And we haven't commented necessarily about the first quarter, but certainly that's where the demand we have to watch in terms of how that will play out. I just don't know from a comp standpoint. Certainly, from our [ph] selling (00:17:48), the comps get easier in the back half of the year, but I don't know what that necessarily means.

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Andrew Obin
Analyst, BofA Securities, Inc.
Q

But for you, what should we be thinking? For you specifically at Carrier, right now, anticipating destocking in the second half?

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

Yeah. There is some level of destocking embedded in our [ph] outlook (00:18:01).

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And has that thinking changed so far this year or is that pretty much in line with where you were at the end of last year?

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

It's in line what we expected back in February when we provided guidance.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Got you. So, maybe we can talk about sort of just broader residential cycle and how to think about replacement because I know there are people who use that framework. I know that's not necessarily your framework, but just – can we talk about as equipment is getting more sophisticated, more energy efficient, what is the life of this equipment in the field and how do you think about it?

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

So, we do believe that the life of the equipment has shortened a little bit. So before we're thinking the high-teens, maybe 17 years or so in terms of life cycle, we think now it's probably closer to 15 years.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Oh, wow.

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

So, it's a little bit...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

It's longer than [ph] what I thought (00:18:55)...

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

It's a little bit shorter than what it was before.

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Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

But then again, with – if you move towards more heat pumps and heat pumps, of course, can do both heating and cooling...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

...there's a thought that with the move towards more heat pumps that could shorten some of the life cycle because you have one piece of equipment doing both heating and cooling.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Got you. And maybe this is a very, very interesting angle because I think you are unique in that you own some of the key components of your Asia supply chain, specifically Toshiba and Giwee, and I know that the focus right now for these products in Asia. But I think it does open very interesting opportunities for you in North America, particularly [ph] inverter (00:19:41) heat pumps, can you talk about the technology path, right, A, just maybe explain to folks what is it Toshiba do in Asia? What are they do in the US today? Where can you take that? And maybe the same thing for Giwee, because [ph] at AHR I didn't (00:19:59) appreciate. Well, I'll let you talk about Giwee yourself.

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

Good.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

How – what's – how do you envision both Toshiba and Giwee brand in North America down the line and what doors does it open for you in Asia?

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

So, Toshiba Carrier was a joint venture between Toshiba and Carrier, longstanding, couple of decades. We were the minority partner and about a year ago we bought out our partner. And so, we own now about 95%. We actually own 95% of this. We're very excited about this acquisition. We paid about $900 million for $90 million in incremental operating profit. In addition to that, we committed to $100 million in cost synergies, and we're confident we'll do more than that.

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Besides the financials, the reason why we're interested and very excited about this acquisition is one direct access to VRF technology with a leading player in Asia. So, [indiscernible] (00:20:57). As Andrew you were referring to, we now have a direct ownership of differentiated inverter technology. Again, really attractive to us as well. Three, Toshiba also has compressor technology.

And so, those three things enable us to do a few things. One, they enable us to compete in Asia in a growing market with a very strong brand, Toshiba. We will continue to operate under that brand for several more decades. Two, we can use some of that technology in other regions of the world. And one part of the world is right here in Europe. All of you probably have read about a significant shift towards more heat pumps. The technology from Toshiba helps us with heat pump technology for residential applications in Europe. It's a key area of growth for us. So, with the acquisitions of Giwee and Toshiba and our existing footprint here in Europe, we're focused on growing the residential heat pump space in Europe, but we can also use this technology in the US, not just the inverter technology, but longer term we are also looking at the compressor technology.

So, it's an acquisition that helps us from a commercial point of view, technology point of view, and we can scale this in different parts of the world. And actually in our very first meeting this morning, one of our Scandinavian investors that we met with mentioned how pleased he was with this Toshiba unit he had installed because it's so efficient, significantly reduces his energy bills at home. And so, it just confirms it's a differentiated offering, attractive not just in Asia and in Europe, but also for heat pump applications in this region and then for technology point of view [indiscernible] (00:22:44).

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And Toshiba and Giwee, they have independent presence right now both in Europe and in the US, right?

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

We are – Giwee is mostly in Asia.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

And so, basically what we have now is a tiered branding, particularly in Asia where Toshiba is the premium brand, then Carrier, then Giwee.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Okay. And is the idea is that over time the compressor technology and all the – you can integrate the back end of it?

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

That is the plan. So, first is the heat pump opportunity in resi in Europe.

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Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

But then, of course, looking at how can we use that technology in our home market in the US as well.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Got you.

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

A

So, very pleased with that acquisition.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

I think it was very interesting. [ph] I was able to just make it (00:23:31) at AHR Show. It's very interesting how Asian players are because of the integrated compressor technology...

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

A

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

...and because, right, heat – Asia is the biggest heat pump market. I mean, I think, people underestimate, in my view, the IRA and heat pump...

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

A

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

...emphasis that it has opened the door, I think, for a lot of technology from Asia into the US and places like Massachusetts and...

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

A

Yeah.

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Andrew Obin
Analyst, BofA Securities, Inc.
Q

...Illinois to this technology. And I think you are the only vertically integrated player.

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

We're very pleased with our position. And if I look at the heat pump footprint that we have, our direct heat pump sales are probably about $2 billion. If you include then the VRF technology and what we would sell through some of the JV partners is probably well over 2x of that.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

The – from commercial HVAC applications, the two large markets, we believe are China and US.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

We believe we have leading positions there, leading position in heat pumps in residential applications in the US. And so, as I mentioned earlier, our focus now is the residential heat pump market in Europe with the very significant incentives that are available here. And that's both an organic play as well as an inorganic play for us.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And can we just talk a little bit about; A, what opportunities do you have in the commercials, right, because I think residential heat pump market. But on the commercial side, what is your client position on the commercial heat pumps? And what does Toshiba and Giwee do, if anything, to help you on the commercial side in heat pumps?

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

Toshiba will probably help us more on the light commercial side...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

...than it will do on the commercial side.

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Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

On the commercial side...

Andrew Obin
Analyst, BofA Securities, Inc.

Q

That's the [ph] core of (00:25:25) Carrier.

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

A

Yeah. On the commercial side, it's really in Europe with, as I mentioned, leading position, same in China. Toshiba will help us, but mostly on the light commercial side.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Got you.

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

A

The Commercial HVAC heat pump will be mostly organic investments.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Okay, fantastic. So, maybe we can talk about the incentives and...

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

A

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

And a lot to talk about this. So, can we just talk about, A, how do we think – so, I think it's a two part question, right. One, I think the early incentives were related to educational investment. And I think broader clearly, there is impact from the IRA as well.

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

A

Yes.

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Andrew Obin
Analyst, BofA Securities, Inc.
Q

So, maybe two separate issues. A, how much is still left to go on the education front from the original stimulus? How do we think about the IRA and it does seem that sort of government's ability in the US to staff, it's just the government's just not writing checks fast enough. What is the timing and how delayed is it?

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

Yeah. So, the first incentive or yeah, the first incentive that Andrew was referring to was Kindergarten through 12th in the US, $190 billion made available by the government to invest in schools, upgrading their HVAC systems and basically the infrastructure. We are seeing the benefit of that and actually less than half of that has already been build out of these funds.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Okay.

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

And so, more than half still has to come.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

K through 12, as we call this in the US, that business in the US used to be about 10% of our commercial HVAC sales.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Yeah.

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

Has significantly increased. Measuring it is a little bit of art beside science, but we think it's probably about 2x of what it used to be.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

As a percentage of North America.

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

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Yes.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Okay.

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

A

And so, still a lot of runway there to go because less than half of the funds has been doled out.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Okay.

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

A

And so, we're seeing that. We're working with the biggest school districts, how can they find the money? What is the right equipment, Carrier equipment, of course, to invest and to upgrade their systems. The Inflation Reduction Act is more recent, actually passed earlier this year, and there is still some of the fine print that is being determined. I'd say do we expect big tailwind of that this year? Probably not. But again, this will be something where we will benefit from.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

And an example I can provide is a little bit personal. I bought a new system earlier this year and I bought a heat pump, and I could choose between different levels of efficiencies. And the cost from – going from a lower level efficiency unit to a higher level of efficiency is a higher cost, meaning more price to Carrier that in – more than that entire difference was offset by the tax credit that we'll receive.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Okay.

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

A

And so, what the IRA will do, we expect is, one, may drive more unit sales because people want to take advantage of the incentives available, certainly a possibility. The two, for sure, what we think it will do, it is – will push people and obviously that's the intention towards more efficient units because it more than pays for itself.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

And with the incentive. And so, the result for Carrier, of course, is we will sell – we call it the mix up. We will sell more efficient units, more higher price unit and the margin dollars per unit are, of course, higher than the lowest efficiency units. Now, what I explained there, if you look at other countries, including in Europe, most countries have their own individual incentive plan to incent people to move towards more electrification, and we see that happening. And that's something that we think will last many years. The EU has an objective of implementing 30 million more heat pumps just by 2030 as all of that will be beneficial.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

We have a question from audience. Those have been hard to come by [ph] from my presence here (00:29:38), so I'll take it.

Q

Thank you. Good morning. I've got actually a few questions regarding the heat pump business. So, I'd like to understand a couple of things. The first one is, so for you, is heat pump as profitable as the, I would say, whatever, regular HVAC or...

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

A

Yes.

Q

... [indiscernible] (00:30:01), that is as profitable.

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

A

Yes.

Q

Okay. And the other question is regarding inorganic growth that you were talking about, especially for Europe. So, I mean, overall in the US, if we start with America, would you say it's a very fragmented market, fragmented market? How do you look at the market because when we look at European players and that's the main way for us to look at it, like small players, whether it's Ariston or any other small players like that. In Europe, it's extremely fragmented market. So, when they try to go inorganic, that – at least that's the way I say it, they look at mom and pops businesses sometimes, sometimes slightly bigger businesses. But it's a very, very fragmented business. And obviously, depending on what part of the business you're willing to address, the profitability is not the same. The kind of customers you're going to address is not the same as well. I mean, for example, in Europe, you go from low end, especially because of what you said, the incentives. It's very, very profitable for customers to move from gas to heat pump because of the incentives. It's the case in France. It's the case in a lot of European countries. But obviously, if you buy Ariston or whatever, if you buy Daikin, it's not exactly the same for the

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customers, not the same for the margin as well. So, where would you want to compete, low end, high end, everywhere?

So – and also, since everyone is willing to go inorganic, we've seen a big acquisition of Ariston in Germany. Do you think that the overall metrics, valuation metrics, is going to still work or do you look at it in terms of return on capital employed?

And the last question is all about heat pump. And the last question is what about the grid, because it seems like in some countries, people are rushing to heat pumps but then the grid is not enough. So, it's not as good as the customers were expecting it to be.

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

A

There were quite a few questions there. Maybe I'll – I mentioned the profitability, I start by saying, yes. And let me provide some additional color there. A heat pump typically replaces a legacy boiler and the price of those heat pumps can be 3x of what it replaces. And so, it's significantly higher priced per unit. And so, the margin dollars are significantly higher as well. And so, we really like the profitability and the margin profile of heat pumps, whether it's in the US or elsewhere.

Two, in terms of acquisitions, I mentioned earlier that our approach to heat pump is both an organic play, because we have the technology available with the acquisitions we made, Giwee and Toshiba and our existing footprint in Europe with our [indiscernible] (00:32:49) business. So, clearly, there is a focus on organic. We'd like to complement that with inorganic investments, i.e., acquisitions. And you're right. There is no one single leader in Europe. They tend to be smaller, family-owned business or independent companies, which means that also it makes it difficult for them [ph] necessarily (00:33:09) to be available but it's a focus for us.

And so, we are focused on our organic playbook, but at the same time if one of these assets would become available, and of course, we would remain disciplined in terms of pricing, the returns it generates, we would absolutely be interested in looking in that space.

I think the last part of your question was...

Q

Right.

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

A

...more about the grid. Clearly, all governments will have to make continued investments in the grid, not just for the EVs but all the electrification that is happening, whether it's heat pumps, whether it's the electrification that's happening in the cold chain. That will be a key enabler for all of that.

Q

So, how about Applied? That's a small part of your business.

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

A

Commercial HVAC?

Q

Yeah.

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

A

Yeah.

Q

Can we just talk about what are the lead times for Applied...

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

A

Yeah.

Q

...right now? And I think the two things that we're concerned about into 2023, right, if you look at the state where the interest rates are, right. Commercial real estate clearly not doing really well. If you look, muni bond issuance last year was flat, I think because of interest rate...

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

A

Yeah.

Q

...dislocations like down 25% year-to-date. If you look at tax receipts, that's relatively flat, right. So – and I appreciate that there are a lot of – there is – there is a wall of tax incentives coming out. But can you just sort of put together thinking about Applied for 2023, given the headwinds and tailwinds on the balance?

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

A

Well, we expect commercial HVAC to be up mid- to high-single digits this year. We had eight quarters of double-digit order intake. It's one of our businesses, whether it's commercial HVAC, light commercial HVAC, North America truck or trailer, demand is not the issue. It's more we're focused on making sure we can serve all of that demand.

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Q

Okay.

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

A

We have not seen any signs yet on our business of that slowing down. And again, we talked earlier about some of the secular tailwinds. We believe that they're going to be there for a while. And so, that move towards more efficient units, not just commercial HVAC, but also light commercial, the electrification of the fleets in transport refrigeration, those are long-term trends. Might there be a little bump on the road, sure, but we're not seeing signs of that yet.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

And on the Applied, we have a couple of minutes, my understanding that, for example, a semi fab would have a very, very large HVAC unit, like, we've heard numbers like a $10 billion fab would have like $250 million HVAC unit. Is there – A, are you seeing orders there? And B, we've heard concerns in the industry about just capacity availability to service it, because I think some of the capacity comes from the data centers. So, A, are you seeing orders? And B, do you need to increase industry capacity to service the build out on the fab side, maybe EV side? I guess fabs is probably more important.

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

A

I think it's fair to say that as we see some of these bigger picture investments, we expect to benefit from these. The benefit, frankly, that we see of the sustainability focus, some of the incentive focus is today bigger than what you referred to. We are not yet in a position where we have to increase capacity. With the existing footprint that we have, that's not the key issue in some areas. It's really supply chain more than bricks and mortar.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

I guess we have one more minute. So, what worries you about – are you concerned, as I said, interest rates, credit availability, tax receipts, does that concern you in any way as a headwind for the Applied business in 2023 and 2024?

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

A

For this year, because we have so much in backlog, I don't see that.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Okay.

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

A

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For next year, again, we have not seen the signs yet. And frankly, those signs may not come because our orders continue to be really healthy.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And are you seeing any sort of – what are you seeing on light commercial?

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

Again, demand, very strong, and it's more about meeting that demand. Again, very well positioned, came up with new products, more efficient and so significant tailwinds to that business.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And let's just get Refrigeration in the last 30 seconds. I think the truck cycle looks peaky, but as we think about...

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

People said that a year ago and we grew last year, and then they said that about this year. We – North America truck and trailer, we think will be up over 10% this year.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Yeah.

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

Again, very strong order intake in the US, in India, in China, where we see secular tailwinds. Europe very well positioned for the first half of the year. We'll see what orders do in the first half to position us for the second half. But, again, very good business and the move towards more electrification is a big tailwind for that business because we have a lot of electric units now on the road. We are the leader. We are now in 14 or 15 different countries, significantly outperforming some of our competition in the space and it positions as well for the future.

Andrew Obin
Analyst, BofA Securities, Inc.

We are out of time. Thanks so much.

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

Thank you for having us, Andrew.

Unverified Participant

Thank you.

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Andrew Obin

Analyst, BofA Securities, Inc.

Yeah, of course. Thank you.

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