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Carrier Global Corp. (CARR)

BofA Global Industrials Conference

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CORPORATE PARTICIPANTS

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

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

OTHER PARTICIPANTS

Andrew Obin
Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Andrew Obin
Analyst, BofA Securities, Inc.

Good morning. Welcome to the third day of our Global Industrials Conference. I'm Andrew Obin, Bank of America's multi-industrial analyst based in the US. And very, very happy to have with us this morning team from Carrier. We have Patrick Goris, Senior VP and Company's CFO. And we have Sam Pearlstein with us, who is heading up the company's IR efforts. Gentlemen, thanks so much for joining us in London. It's always a pleasure.

I think Patrick is going to make some short comments. He has some slides. And then, we'll go over to a fireside chat format. Thank you. Patrick?

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

Good. Andrew, thank you. And thank you for having us here. Good morning, everyone. As Andrew said, I have a couple of words I'd like to – or a few slides I'd like to share with all of you. First of all, a brief overview of Carrier. Carrier is a global leader in intelligent climate and energy solutions. In essence, what we do is we make environments more comfortable, we make them more safe, and we make them more sustainable. And electrification, the entire electrification movement, we're in the middle of all of that. We operate three segments. Each of these segments is a market leader in their respective space. And we invest in digital platforms, such as Abound and Lynx, to increase digital revenues, but also to increase our aftermarket business, which as I'll talk about, provides significant upside opportunity for Carrier.

Now, one year ago, I shared you this slide, and those are the five key elements of what I call our investment thesis. And all of these remain very valid today. And as you can see on the bottom of the slide, we actually made progress on every single one of them over the last 12 months. But particularly, of course, the one on the far right with respect to portfolio transformation, that's an area where I'd like to talk a little bit more about next. So, in April of last year, we announced an important change in our portfolio. First of all, we announced the combination with Viessmann Climate Solutions, a leader and climate champion in Europe in the residential and light commercial

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HVAC space in this region. In addition to that, we announced the exit of about $4 billion of our existing revenues, Fire and Security business, Commercial Refrigeration businesses, all good businesses, well positioned in their space, but we no longer believe we're the best owner of these businesses.

The outcome of that is a company that is more focused on HVAC, climate, electrification, energy transition. It's a company that is simpler to run, simpler to understand, much fewer competing priorities, and frankly, a company that has a higher growth profile as well. And as we'll talk about, we're in the middle of that transition as we talk about now [ph] and we've actually made (00:03:04) attractive progress so far. So, when this transition is done, we'll be a company that, as I said, is much easier to understand and to operate. And the way – one way you can think about it this is a company that has three main product lines or businesses with leading positions across the globe. First one is Commercial HVAC. Think of heating and cooling systems, smart heating and cooling systems for buildings like these, for hospitals, for airports, all of that. We already have very strong positions in every part of the world for these businesses.

With the acquisition of Toshiba Carrier in 2022 and the combination with Viessmann Climate Solutions earlier this year, we significantly enhanced our positions in Asia and in EMEA with respect to Residential and Light Commercial HVAC. Our home market, of course, being the Americas, we have the leading position in Residential and Light Commercial HVAC in the US. So, global scale across key businesses in the HVAC space. At the bottom of the slide, you see our Transport Refrigeration business. Think of that as being truck/trailer, sea containers. We have a long history of being a leader in that space. And again, we have very strong differentiation in technology across the different regions in the space. So much more simplified company with leading positions, high exposure to attractive end markets and benefiting from secular trends, including the entire move towards electrification and energy transition.

So what does that do to our value creation framework? You may have seen this slide before. This is how we intend to drive value to our shareholders over longer periods of time. It remains unchanged. However, what we have said is that given our changed profile post the transformation, we expect to be a higher growth company. So what we've said is, over time, we are more comfortable with the higher end of the organic growth range you see here. So 6% to 8% organic growth was based on 3% to 4% GDP growth. Given those levels of GDP growth, we're more comfortable with the higher end of the 6% to 8% range. Margin expansion, no change there. We expect and target, at least, 50 basis points of margin expansion every year. We'll talk a little bit about productivity next. We always focus on tax efficiency and on strong free cash flows to generate more capital for us to redeploy. And the outcome, as you can see at the bottom, is we target continue double-digit adjusted EPS growth going forward.

Once the transformation is behind us, and we're only a few quarters away from this, the company will be even more exposed to some of the secular tailwinds you see on the left side of this slide. All of these are important drivers that, in essence, have a positive impact on our business and those impacts you can see in the middle of the slide. In essence, climate change, the move towards more electrification, the move towards more sustainability, all of that drives more demand for our products. And the more efficient the products people want and desire, the higher the price point, the higher the margin dollars per unit. So we are benefiting from significant secular tailwinds across all of the remaining businesses that we'll have in our portfolio. And we'll have a very attractive portfolio, as I mentioned, across the different parts of the world, and I think that what we're doing is being recognized.

Even before the transformation is complete, we see – the recognition we see on the right side of the slide, I think many institutions and organizations see us at the very middle of what's happening from an energy transition point of view. And as we would say, this is just the beginning, because we're not done yet with our transformation, as we'll talk about. So a little bit about aftermarket, and I think it's hard to understand the full potential of Carrier

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without understanding the aftermarket opportunity. What we call aftermarket, think of the aftermarket revenue base – that we get, extract from our installed base. At $5.5 billion, we still think it's only about 25% of the total market – total aftermarket revenue available with our installed base. We like it because it's recurring revenue, it's existing customers, it's asset-light and on average 10% higher gross margins than the overall company, so a huge focus for us. Every business in the company has aftermarket targets.

We target that business to grow, as you can see here, high single digits to double digits. Dave Gitlin likes to say double-digits forever; this focus will not stop. Once the transformation is finalized, we actually expect the growth profile of the aftermarket business to be higher, even though the base will be slightly lower than what you see on this slide. Another area that is, I think, somewhat unique to Carrier is the opportunity for productivity and simplification, and some context around that. For more than 40 years, Carrier was part of a conglomerate; and now for about four years now, we're a stand-alone company. By each metric that I can think of in terms of complexity, we're overly complex. That is an opportunity. Number of vendors, [audio gap] (00:08:34) there are few that you see on the slide. Another example is the ERP systems. When we spun, we had over 100. By the end of next year, we'll have less than 50.

So while we have been transforming the company, we've been making significant investments to simplify. Of course, the exits help as well, but the outcome will be a company where we will be able to have significantly more scale benefits of the infrastructure that we have and an opportunity to drive more margin expansion over the next several years given the opportunities you see on the slide. I'm not going to go, of course, through all of these, but one that I'd like to touch on is under product development. You see there leveraging global scale. And I think with the acquisitions of Giwee, Toshiba, and Viessmann over the last just two, three years, we have an unique opportunity because each one of these businesses either buy something from the outside that someone else within the companies that we make within the company or there is an opportunity to pick best-in-class technology from the different businesses that we have and to scale that technology globally.

And so, I call this we have a puzzle in front of us where we can pick the best, scale it globally, get tremendous scale benefits, and further simplify our business. So, again, another example where I see the size of the tremendous secular trends we benefit from, we have a unique opportunity internally to simplify what we do more than just the portfolio to drive out cost, to reinvest in our business, and to expand our margins. A little update on the business exits. We announced these late April of last year. Three of the four exits representing 70-or-so percent of the EBITDA being divested we have announced definitive agreements. We haven't closed on the transactions yet, but we expect for the three divestitures that you see on this page with the checkmark, we expect about $5.5 billion of net proceeds to receive this year, all of which will go towards paying down debt.

And the outcome of this will be by the end of this calendar year, we'll be on track to about 2x net leverage. And that is important because what we have shared with you at the time of the announcement of the divestitures is once we get to about 2x net leverage, we expect to return to share repurchases. And we have a very strong desire once we get to about 2x net leverage to repurchase at least the equivalent shares issued to the Viessmann family. So, we issued almost 59 million or call it 60 million shares as part of the acquisition; we expect to repurchase these shares as quickly as possible. With the proceeds of the acquisitions, the de-leveraging will be mainly behind us which means that we have significant firepower available for us going forward to make those share repurchases. A little bit about 2024. Given all the puts and takes, the acquisition and all the exits and the different timing of the exits, probably not the easiest to understand moving pieces.

But a key element, and that's why we put the slide together, is looking at our core business which is the dark blue. Think of the core business as the businesses we are keeping, HVAC, Transport Refrigeration, and the Viessmann business. That business this year combined is growing at about a 15% adjusted EPS level. And of course, then

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the question is, is what does that mean for next year given we expect next year to be a cleaner year. And so I thought I'd provide some additional color on that here. So, assuming we achieve from the core business this year $2.55, there are some additional levers besides just core growth performance that can help us accelerate the adjusted EPS growth. First element is we expect our growth business – our core business to grow. And what you saw in the value creation framework, we expect that to grow at double-digits each year. So we would expect all else equal or we would be disappointed if we wouldn't do that again for next year.

Then, in addition to that, for next year, we get to redeploy some of the proceeds of Industrial Fire that is new since we announced our guide for this year. So, next year, we'll get about three-quarters of the benefit of lower interest expense that will add to the $2.55. In addition to that, we have the last exit, which is Commercial and Residential Fire. That's about $200 million in EBITDA that we expect to exit this year, sale or public market exit. You can attach a multiple to that. Those proceeds will also be available to us for deployment. And in addition to that, there is the free cash flow we generate after paying the dividend. This year, that's about $1.4 billion. Next year, put some growth rate to it, roughly combined, that's $3 billion. So basically, what we're saying is, next year, core business would expect to grow at a healthy clip. There is a benefit of lower interest expense and then there is significant capital available for deployment that we intend to focus on share repurchase and that will further boost our earnings growth for 2025.

And the takeaway here is, of course, the message we'd like to send is we see an opportunity here given the exits that we've announced, given the net proceeds that we expect to get, plus the free cash flow generation from this year and next year to have attractive earnings growth into 2025. So, in closing, a lot happening at Carrier, but we are at the middle of some really attractive secular trends. The electrification movement is real. We're seeing that across our portfolio. We're seeing companies move towards more and more efficient solutions. We only benefit from that. The transformation we're going through exposes us just even more to those secular trends. In addition to that, we have tremendous opportunity to simplify what we do drive cost out, which in turn provides us resources to reinvest in the company and expand our margins.

And there is a significant focus, as always, on free cash flow to make resource available to deploy capital and a key element of capital deployment after the debt paydown will be, of course, repurchasing shares, as I just mentioned. And as a result of this, as you can see on the bottom, we expect that, as a result of this, that our multiple, over time, of course, will increase, because we'll be simpler, higher growth profile with tremendous growth opportunities ahead of us.

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

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QUESTION AND ANSWER SECTION

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah. Thanks so much, Patrick. So, yeah, maybe just to go to the growth algorithm, and thanks so much for an update. So, sort of you highlighted [ph] 5% (00:15:44) as a base and you highlighted double-digit growth in the core business. What are the macro assumptions driving the double-digit growth in the core business, if you could just go through the major buckets.

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

A

Good to do it. And I'll talk about the value creation frameworks over longer periods of time. What we said is the underlying assumptions for 6% to 8% organic growth is GDP growth of 3% to 4%. On top of that, we see additional drivers. The aftermarket is an opportunity for us that I just laid out that goes beyond GDP, because that's revenue that's available with our installed base today. In addition to that, there are new revenue streams available to us. Some of them impact the aftermarket business. We talked about our digital platforms. Lynx for the cold chain. We talked about Abound for businesses, incremental revenue opportunities. And then if you look at the revenue growth, some of it is not necessarily driven by volume. Some of it is driven by what we call the mix-up.

Every time we sell a more efficient Residential HVAC unit, every time we sell a more efficient Commercial HVAC unit or Transportation Refrigeration unit, the price is higher because the customer gets more value and more benefit. So the move towards higher sustainability automatically puts an uplift on our sales growth. So those are the elements that drive to the 6% to 8%. And with the transport – the change in the portfolio, we're getting more comfortable with the higher end of that range.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Got you. So, but effectively, for 2025, if I'm thinking about it, you feel comfortable with your view of macro if you go through the various end markets that we are getting this mid-to-upper single-digit revenue growth. That's what underpins the assumption for the core business growing in 2025. [indiscernible] (00:17:39)

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

A

I understand the question. I'm not going to provide guidance, particularly...

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah. I know. I got it.

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

A

...2025. What I was trying to lay out was we would be disappointed given our value creation framework...

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Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah.

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

A

...that we would deliver anything less than double-digit. Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

No, I got it. But just underlying sort of the growth somewhere within the framework.

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

A

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Okay. No, I did not mean to pin you down. That's very fair. And then maybe as long as we're sort of talking about it, just to make sure you've outlined $1.4 billion of cash generated this year and then you've sort of generated – not generated, $1.4 billion available, and then you sort of generated – look, it's probably going to be the better next year. Just to assume, so you did mention the number $3 billion. And is that sort of a good placeholder to use available for buybacks? Are there just – for 2025, is $3 billion a good starting point to think about money you have available to return to shareholders, deploy for M&A or whatever you want?

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

A

Yeah. The way I'm thinking about it is, this year, our free cash flow after paying the dividend...

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yeah.

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

A

...will be about $1.4 billion, and I take out the taxes on the gains and so on. We expect that to grow in 2025. We would expect our business to grow. So that together is $3 billion that we would focus on share repurchases. In addition to that, there are the proceeds – any potential proceeds, of course, related to the Residential and Commercial Fire exit...

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

...that would come on top of that. And so if you combine that, I'm seeing $3 billion plus available to us in terms of capacity, which, by the way, would be very consistent with our objective to buy back the equivalent shares issued to the Viessmann family, which is about 60 million shares, which would at today's share price would be about $3.5 billion of share repurchase. So we see a path starting late 2024 throughout 2025 for significant share repurchases.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And just remind us, it seems you are ahead of your pace on de-levering. So how does reducing debt fit into this framework?

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

Yeah. We think that with the proceeds of the deals that we've already announced, the three, so Security, Commercial Refrigeration, and Industrial Fire, net proceeds of about $5.5 billion, these will all be redeployed towards debt reduction. We'll get back to about 2x net leverage by the end of the year, a year earlier than what we shared with investors back in April of last year. Rating agencies have been supportive. They know what our plans are. And so, given that the de-leveraging will be mostly behind us, we see as being very active on the share repurchase side, consistent with the message that we've sent to all of you, which is we expect to reduce the shares – at least, the equivalent shares issued to the Viessmann family as soon as we can.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And then, the leverage beyond that just EBITDA growth and [audio gap] (00:20:49)...

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

...consistent with the Baa2 rating from Moody's which is about 2.5 times adjusted debt-to-EBITDA.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

That's great. Thank you. And just [indiscernible] (00:21:02) can you remind us what are you sort of thinking about – what are you seeing in terms of – I think some of your competitors have provided updates. What are you thinking in terms of first quarter? Any updates? If you can remind us what the framework is and is there any updates to the framework you're willing to share?

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

For Q1, frankly, we had said back in February we expect sales to be a little less than $6 billion.

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

$6.5 billion.

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

Sorry, $6.5 billion. Adjusted EPS of about $0.50 and, frankly, that's where we expect to be. So, comfortable with both of these numbers.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Excellent. So, yeah, so maybe we can go – I think there are some headlines also. Can you just also update us on the bankruptcy process for KFI? Where are we because, as I said, it seems there's been headlines? And how is the bankruptcy affecting the timing of the Resi and Commercial Fire divestiture?

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

Yeah. So, KFI in terms of...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And maybe you can remind the audience because this is like getting into the weeds.

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

Yeah. I was [ph] quite alluding to the (00:22:07) context, yeah. KFI was a subsidiary of Carrier. And to the extent that there are any AFFF liabilities in the US, we strongly believe and I've always believed that they reside within KFI. So, in May of last year KFI, with an independent board, has decided to file for Chapter 11 and has been in a Chapter 11 process since then. Earlier this week, court papers – files were – documents were filed with the courts announcing that KFI has found a buyer, and so a buyer now is in the process of acquiring KFI. I think that is till April 1st of this year. Other companies can look at all the document and see if they have an interest in putting in a higher bid. Our expectation is that all the proceeds associated with that transaction will be used to satisfy any potential claims associated with AFFF.

The Chapter 11 process is still, of course, ongoing even though the sale is imminent. We're in mediation and what we've said is we feel very strongly in the corporate veil that we have and that if – to the extent there are any liabilities, they reside within KFI. And so, we'll see how that plays out over the coming months and quarters. With respect to an impact on the exits, given the exits already announced, I think it's fair to say that it has had no impact...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

...on the exits to-date.

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Andrew Obin
Analyst, BofA Securities, Inc.
Q

And just to make sure if everything goes, I don't know, according to plan, but there is a scenario under which, sort of reasonable scenario under which all the AFFF liability will reside with KFI with sort of nothing left for anything.

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

Well...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

I know that it's up to the courts, I know. That's why...

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

Yeah. I'll just repeat, yeah.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Of course, that's why you have lawyers.

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

Yeah. That's why we're there. But I'll just repeat to say that to the extent that there are any AFFF liabilities, Carrier, we have always said that...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

That's right.

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

...we believe very strongly that they reside within Carrier.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

No, that's right because you have a very unique structure.

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

Yeah. And we believe we have very strong – yeah.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

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What differentiates you from your peers is that all the activity was always contained within KFI and it is a real difference between you and your peers.

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

That is our belief.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Yeah. No, [ph] that takes care of everything (00:24:38). Okay, maybe we can just sort of talk about, to switch – you sort of highlighted opportunity to grow attachment with services, so maybe we'll spend a little bit. Yeah, can you just talk about sort of opportunity to attach software solutions like Abound and Lynx to Carrier installed base? Why hasn't – why historically, I think, you haven't been more active?

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

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And changes are you making to sort of drive this change in business?

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

So, it's interesting but, historically, Carrier was very focused on selling equipment and mostly was a one-time sale. And there may have been some spare parts, but it was not as much focused on the entire – on monetizing the entire lifecycle of the products. And frankly, I think one of the changes that happened was just before the spin, some of our executives, including of course our CEO, coming from the aerospace side of United Technologies where a lot of the money is made on the aftermarket, [ph] he set to (00:25:46) identify that as an opportunity. So since then, a tremendous focus on aftermarket has been growing the last three years at double digits, but the opportunity is tremendous also because we have such a huge installed base. And I'll give you an example, and I won't use HVAC but I'll use our Transport Refrigeration business. The cooled trucks and trailers you see on the roads, we're one of the few companies that operate in this space globally, including the sea containers.

There are over 1 million cooled sea containers on the oceans that are Carrier units or that we sold, and so historically it was a one-off sale. And then, of course, we try to get some parts business or maybe some maintenance, but it was little of a recurring revenue associated with this. With the development of our digital platforms, in this case, the Lynx platform for the cold chain, basically what we're doing is we want to connect these units. We want – we provide value to our customers. So we charge a monthly fee. So, a few years ago, zero percent of these units were under a subscription agreement. Today, over 100,000 of them are under a paid subscription. What does that mean? Yes, we get a monthly fee, but there is value that we provide, of course, to these customers going forward. By paying this fee and having the connectivity, we can see real time, our customers can see real time what's the performance of this cooling unit? Is preventative maintenance required? Is a unit about to fail?

By doing this, we can significantly reduce number of times of either downtime or the loss of the content of those containers. Those contents can be really expensive, it can be medicine, it can be expensive food moving from

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one part of the world to another. And so, the beneficiaries of this, of the value that we can now create are multiple. It can be the producer. It can be the shipping company. It can be the recipient at the end, because the recipient now has the higher level of comfort that the goods were kept at a certain temperature or humidity level throughout the voyage. But of course, one of the recipients now is also the insurance companies, because we can help reduce claims. And so, this is just one example where by investing in digital capabilities, in this case, the cold chain, we create new value to customers, new revenue streams. And it's, of course, on us to convince our customers to invest and to pay additional monies and, of course, convince them that our returns are associated with this.

Whether it is in the cold chain through Lynx or Abound with buildings, the same principles apply. And so, it's just – we want to grow our aftermarket business in general, including the parts, including the services. We are especially interested, of course, in where we can provide digital services that can be scaled globally, because you can imagine once you provide that service and you can – scaling it from 100,000 units to 200,000 units does not require an equivalent change in investment. And so that is a key opportunity for us and that fits into the double-digit aftermarket growth forever that we're targeting.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Got you. So maybe sort of the remaining time we can go ahead some of the key end markets. So, we are in Europe, so maybe I will start in Europe. Your tone on heat pumps and Viessmann, you have a very – you have a different message, right, I think, from your competitors. Can you just remind us what is different about Viessmann's business model, right, because I'm on the record being more conservative about Germany than you are. But it does seem that there is a belief that fundamentally your business model differentiates you from your peers. So, can you just tell us what's the difference in the business model for Viessmann versus the competitors? And how does it – how will it impact 2024 and 2025 for Viessmann?

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

Well, if I look at the business itself, the way it's differentiated, first of all, it's not just a heat pump company.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Of course.

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

It's a company that has a very broad offering, whether it's the boilers, including the heat pumps. And of course, they put together the overall package, whether it's solar, the battery system, sanitary hot water and the home energy management system. The additional differentiator there is, of course, is their go-to-market.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

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They go direct to installers, which is pretty much unique in Europe. Most companies go through distribution. It also means that whereas some companies may have a destocking opportunity, call it, in this part of the world, that would be a less for Viessmann, because there is no one in between. That being said, of course, they're not immune to what's happening in the market. What we have said for Viessmann for this year, which is embedded in our guide for – that we provided in February is mid-single-digits revenue growth overall for Viessmann for the full year. First half, flattish to slightly down. And we are expecting a pickup in orders that we expect to see late this quarter into Q2 that would help us with better performance in the second half of the year, knowing, of course, that the comps get easier in the second half of the year.

If I look at our performance in Q1, for Viessmann Climate Solutions, I expect our profitability to be pretty much in line with what we expected, even though the sales might be a little lighter.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Got you. And just to sort of make it simpler, the idea is because you have visibility on the installations, the idea is what your backlog is. I think the industry has sort of commented on December applications sort of showing the signs of life. And basically, we have the same debate on the industrials, I think. We've seen like sort of companies are actually really being able to manage through. But the idea is you have enough visibility on your backlog. And by the time you sort of run out of the backlog, you will catch up with easier comps and applications into the second half. Is that a fair way of sort of thinking about it?

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

I would not overstate how much visibility we have. It remains 90% a replacement business. Of course, having fewer steps in between it, provide...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

90%?

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

90% of it is a replacement business revenue.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

All of Viessmann?

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

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Okay.

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

Yeah. And so, mostly replacement business. So some of that is a short cycle business. But given that there is not that step in between, of course...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

...in theory, better visibility. I will also say that we're taking advantage of the current environment to just double down on the cost synergies. So we have shared that we target over $200 million of cost synergies. Those are really sourcing procurement synergies. And what we're doing now is really very high activity on accelerating these basically and pulling these forward. And so, for the moment, early – we're only three months in. But clearly, we think we're making good progress there, which also means that as the heat pump business and the business overall even accelerates that we expect the incrementals to be that more attractive.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Got you. Okay. Maybe, we'll – let's hit North America. Let's go to Resi. So, for Resi, destocking is expected to continue in the short-term in 2024. How would you compare it to what's happening through the fourth quarter of 2023, just maybe what happened in the fourth quarter, right, because I think there was ambiguity about EPA's refrigeration transition guidelines? And just how should we think about Resi business returning to growth in 2024 in North America?

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

So, first, we don't think that the EPA guidelines – it's hard to tell whether it had any impact on us in the fourth quarter. I think the fourth quarter was really moving – remained somewhat weak. And of course, we wanted to ensure there was significant destocking in the field, and we did see that. Our expectation is, and what's embedded in our guide for this year, that the destocking will be mostly complete or substantially complete this quarter, and our guide assumes that we'll return to volume growth starting in the second quarter in Resi. And in terms of context, our Resi business was down in 2022 low single digits. It was down high-teens, almost 20% in 2023, so we've had already two years of a downturn in Resi while at the same time, actually, we've been able to grow revenue and expand our margins. And it's one of our most...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

No, your ability – look, the bull argument is that the Resi downturn happened and you still hit your numbers, so I'll absolutely [indiscernible] (00:34:56).

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

So, we'll see. Obviously, it is a short cycle business but we believe that we'll return to growth starting in the second quarter.

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Andrew Obin
Analyst, BofA Securities, Inc.

Q

And how should we think about – as the refrigerant transition, how should we think about the pricing opportunity over the next 18 to 24 – how will that play out?

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

A

Sam?

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

A

Sure. So with the new refrigerant, what we had said was that it would be about 15% to 20% higher price on an equivalent basis over that two-year period, so think of an equivalent unit in 2025 compared to what it was in 2023. For us, in 2024 we said about 20% of our volume would be the new refrigerant. That will show up as a mix benefit for us this year until you get to the point of selling the same product year-over-year, so think of that as a mix element this year as opposed to a price point.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

And then by 2025, all of that is going to be...

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

A

Not all. I mean, it would not be 100%. Just like last year, we didn't have 100% sold from the new SEER product.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Right.

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

A

You would not be at 100% because anything you produce this year you could still sell into the next year.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Oh, yeah, yeah.

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

A

This is another good example where the more efficient or sustainable the products become that we sell, there is a natural uplift from a revenue point of view and margin point of view.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

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Got you. And as we think about – just maybe go to Light Commercial because there are concerns about Light Commercial slowing. I think it's guided to be down mid-single digits, so how should we think about the underlying demand versus inventory and when do we expect that cycle to bottom?

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

If I look at the expectations for Light Commercial for this year, yes, down mid-single digits. But that's after three years...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

...of exceptional growth. Last year, that business was up over, I think, over 30%.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

That's right.

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

And so overall, remains a business at high levels but not unusual levels. The volume levels we expect in Light Commercial for 2024 are lower than they were in 2018 and 2019.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

And so it's a really good business. We've made some investments in more efficient units, units with a very attractive footprint. We think we've gained share as a result of this over the last several years. We just don't expect the business to be as strong this year as with last year, but not at historically high levels.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And how does ESSER funding play into this because I think you have to place orders by September 30? You've been a beneficiary of that, so can you just tell us where the education vertical is at this point? And how do you expect that to play out into 2025?

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

Sam is our expert.

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

Well, not an expert. But certainly, in terms of – you're right in terms of the obligation that's to happen later this year. But you have the ability to spend the funds...

Andrew Obin
Analyst, BofA Securities, Inc.
Q

That's right.

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

...into early – into the first quarter of 2026 is the way to think about it. So you would still see a benefit from those funds into next year.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Right.

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

We've said that education is probably about 20% of the Light Commercial business for us in North America now which is much higher than it was a couple of years ago.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

And so for 2025, you'll still be able to spend what...

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

You would still see a benefit from that in 2025. Yes.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Got you. And maybe in the remaining time, Applied. What are you seeing in Applied? Remind us. You have [indiscernible] (00:38:18) data centers.

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

Well, Applied, again, I mean, a really good business, a global business. You mentioned data centers. Obviously, that's the topic du jour, if across the regions, whether it's in Asia, Europe or in the US, seeing a very strong uptick in data centers. It's similar technology we use, of course, for other applications. But in addition to that, it opens up the opportunities for new revenue streams for different types of cooling, like liquid cooling. And of course, those are areas that we're investing in, in order to be able to provide those capabilities. And interestingly, of course, the Nlyte acquisition that we made several years ago is a differentiator for us, because it helps operators of data centers optimize the energy consumption of the racks they have.

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Andrew Obin
Analyst, BofA Securities, Inc.

Q

And within the Applied, it seems just overall pretty robust market between institutional, between data centers. Any sort of weaknesses outside of, I guess, commercial, I'd say?

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

A

I'd say that's the key area of commercial real estate. It remains somewhat weak in that space.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

And how big is commercial for you?

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

A

Commercial real estate, for the US, that's where we cited less than 10% of our Commercial HVAC business.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

That's right. Yeah. No. Right.

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

A

And so data centers are significantly higher. Education is significantly higher than that. So, overall, we expect to see continued good performance in our Commercial HVAC business.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

And maybe the remaining just let's hit the Transport Refrigeration. Can you just – you are forecasting outperformance. I think people focus on the ACT forecast for trailers...

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

A

Yeah.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

...or refers. Clearly, you're forecasting outperformance. Can you just elaborate a little bit what drives the outperformance versus forecast? What else is in that business?

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

A

Well, first of all, there is the container business. The container business went through a downturn. It's coming out of that downturn. So we expect to see attractive growth opportunities there. The second element is there is a move towards electrification in that business. We already have electric units in more than 10 different countries

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around the world. We think that's a differentiator. Again, those are higher value units. They go for more. So, will we see some weakness in some North America truck and trailer? Maybe this year. But aftermarket focus is there. Container will help us out this year. And so, it's a business that provides significant opportunities, again, long term.

Andrew Obin
Analyst, BofA Securities, Inc.

That's it. We're out of time.

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

Okay.

Andrew Obin
Analyst, BofA Securities, Inc.

Thank you so much.

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

Thank you, Andrew.

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

Thanks, Andrew.

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

Thank you for having us.

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