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Carrier Global Corp. (CARR)

Wolfe Research Global Transportation & Industrials Conference

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CORPORATE PARTICIPANTS

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

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

OTHER PARTICIPANTS

Nigel Coe
Analyst, Wolfe Research LLC

MANAGEMENT DISCUSSION SECTION

Nigel Coe
Analyst, Wolfe Research LLC

Great. So, I think we're live. So, thank you very much. And for the benefit of those who are on the webcast, welcome to the Wolfe Transport & Industrials Conference. My name is Nigel Coe, and I cover the multi-industry companies here at Wolfe Research. It's my great pleasure to be joined on the stage by Carrier Corporation, Dave Gitlin, Chairman and CEO, and Patrick Goris, CFO. Gentlemen, thank you for being here with us.

And Dave, if you want to make opening remarks, and we'll get into Q&A.

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

Thanks, Nigel. Thanks to you and Wolfe Research for having us. Yesterday was a big day for us. We had our first Investor Day since 2022. And the bottom line is that we look back at what we said we were going to do in 2022, and we did what we said we were going to do. We said we were going to grow 50 basis points of margin a year. We grew 100 basis points. We said we would grow our EPS 10% a year. We did 15%. We said we would have cash flow equal to net income. We did that. We did exactly what we said on our ETR and so on.

The key focus we had yesterday was accelerating growth. We said that we would grow 6% to 8% a year. We grew 4%. So, what's changed, and that was the entire focus of four hours of yesterday's Investor Day. We said that the market – we were very, I think, conservative. We said market globally around LSD, which – low single-digits, where we like our exposure to the right verticals, the right geographies and the right secular trends. And then, we went through a three-pronged growth strategy, and we can get into follow-up questions on that, Nigel.

But one was products, where we said we would gain share through differentiated products, channels and brands. One was aftermarket, 25% of our business growing double-digits. That gives you 2.5%. And the new frontier is systems, where we're doing HEMS, complete Home Energy Management Solutions, in Europe and the United States, QuantumLeap for data centers, integrated solutions for things like hospitals.

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So, you put that all together, it's about a third, a third, a third; a third from the market, a third from aftermarket and a third from the combination of products and systems. So, we've done so much over these last five years to get the portfolio just right. We've done so much with our foundation with The Carrier Way, and the team that we have in place. And you got to hear from many of these great leaders yesterday. Now, it's just heads down, be there for our customers, innovate, grow, execute. And we're excited about this next phase ahead of us, growing 6% to 8% a year.

QUESTION AND ANSWER SECTION

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks, Dave. So, we've prepared these questions, and of course, yesterday with the Investor Day, a lot of these questions are now redundant...

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

A

Yeah.

Nigel Coe
Analyst, Wolfe Research LLC

Q

...or have been answered already. But yesterday was all about growth, and the 6% to 8% organic growth is not the most conservative target you'll see out there. So, Dave, what gives you confidence that Carrier can be at that sort of consistent level of growth? Maybe get into the three-pronged strategy.

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

A

I think that if you look at these last few years, we were very much anchored by two very discrete acute areas of weakness, which I think are ephemeral in nature, that you cannot have Europe residential and China residential down 20% forever. So, if you see those markets just come back to flattish, we don't need them – we don't need those markets to be up 20%. But as you see, especially Europe residential come back, the market itself come back to kind of flat to low single-digits, we should very much be able to have the entire portfolio grow in that 6% to 8%. Were they flattish, we would have been growing kind of in those numbers.

So, Americas has been strong, continue to stay strong. You look at European and Asian commercial, those have been strong. Those will stay strong. And I think you look at Germany, total residential units this year will be at like historic lows over the last 30 years. So, just coming off a low base. And then, everything else was that three-pronged strategy, products, aftermarket, systems, each with very detailed roadmaps that we not only shared with you, our investors yesterday, but this is how we run the business. The stuff we reviewed, how are you gaining share in resi in the United States, that's what we share with our board. That's what we do in our business reviews. So, there is a lot of detailed plans behind us that we have confidence in.

Nigel Coe
Analyst, Wolfe Research LLC

Q

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Okay. Market share was part of the outgrowth, and you're number one – clear number one in residential and commercial in the US. You are the number one in Germany residential and commercial. I think you're number one European and APAC commercial. List goes on. There are pockets where you're not. So, the market share gain, being large and dominant, does that just help you gain share or does it just put a target on your back? And what gives you confidence you can actually gain that share?

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

A

I think it's going to vary by vertical, by business, by region. I don't think we'll gain huge share in resi in North America. That's not part of our growth algorithm, where we have very good share in resi, light commercial in North America, very good margins. Our goal is just keep winning and make sure that we retain the share that we've gained. We're probably up 300 basis points in resi over the last three to five years. We're up 100 bps over the last year.

We get the question every time, are some of the competitors going to come back at you to try to take that share? We've converted dealers. We're retaining those dealers. We just keep growing those businesses, and we'll be just fine. Commercial HVAC in the Americas is all upside. We know we're number three. We don't like that we're number three, but we like that we're number three because there's so much room, because we now have the capacity, we have the product portfolio, we've added spec engineers, we've added technicians, we've added salespeople. We've put the foundation in place to grow commercial HVAC.

So, shame on us if we don't take share every year in commercial HVAC in the Americas. There's so much upside. We'll continue to gain share in resi, light commercial in Europe because of what we've put together with Viessmann. We'll gain share in commercial HVAC in both Asia and Europe. And then, it's hard to say with resi in China. I think just – we just need some stability of that market there, but it's only $700 million or $800 million. So, we'll have to just see how that piece of the business plays out.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. Aftermarket was an area where you said double-digit growth forever...

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

A

Yeah.

Nigel Coe
Analyst, Wolfe Research LLC

Q

...which is pretty good. Double-digit growth [indiscernible] (00:12:49).

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

A

[ph] It's a (00:12:49) long time. Yeah.

Nigel Coe
Analyst, Wolfe Research LLC

Q

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[ph] It got us into (00:12:50) pretty big numbers. Now, when you think about the installed base of chillers and other devices, your service penetration, I think, is roughly across the board, I think, about 45%, 40% [ph] or so, 30% (00:13:05) in the Americas. Your parts penetration is very low at 25% on average, I think. Yet, when you take a step back, you think, wouldn't this just be the most obvious thing in the world to milk that installed base. So, just maybe take us back 5, 10 years, 15 years, why this wasn't the priority? And then, how are you scaling that up to where it should be?

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

I'll take this, and then no matter what you ask next, we'll take it to Patrick.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Okay.

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

So, you could ask about my family history. It's going to...

Nigel Coe
Analyst, Wolfe Research LLC
Q

Okay. [ph] I'll think about it (00:13:34).

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

But I will tell you that I cannot answer why it was not more of a focus for us five or six years ago, because it should have been. It's clear that you look at the opportunity around the aftermarket, and there is just so much low-hanging fruit for us as a company. And you mentioned – our parts capture rate was 20% five years ago when we spun. That – all that is what percentage of the parts are going – that we sell, Carrier parts, part of our systems go to us as opposed to go directly to one of our suppliers and bypasses us. It's gone from 20%. We said we're on our way to 65%. So, we've come a long way. But it should be 100%.

So, getting to 65%, we're proud that we're no longer at 20%. We're proud that we've come a long way since then. But you have to actually have the right contractual relationships with your suppliers, with your distribution partners. You have to actually have the parts in situ, so the customer has – when a part fails, they need it. They need it within hours. So, you have to – we have to look at our logistics to give the customers the parts they need them when they need them, and then we have to work pricing. We have to work a whole bunch of approaches on how do we make sure that we capture our parts. But that's just the way of doing business.

Now, when we go to a factory, we open it up and say, do we have our own nameplates on all the parts. Whether it's a compressor, a motor, a fan, a control, we want to see a Carrier label on there as opposed to one of our suppliers. So, there is a whole formula to it. We know the formula. We've come a long way with huge runway, and that's the same with attachment rates, total coverage. We said we've gone from 2,000 connected chillers to 50,000. We've gone from 1 million connected devices to 3.5 million. So, we know the formula. We know exactly how to do it.

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Mods and upgrades. We should know where every single chiller is, 400,000 chillers around the world, where are they. So, we know when they're coming towards the end of their life, so we can actually go to the customer proactively, have them replace it because of energy efficiency savings or other benefits to the customer. So, we know the formula. We say double-digit forever for a couple of reasons. Number one is because we only capture 25% of our own aftermarket today. But two is we know the playbook, we have the team to execute it, and we're still in the early innings because there's so much low-hanging fruit there.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Yeah. This is a follow-on question. So, the next question [indiscernible] (00:15:55) follow-on question.

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

A

Sure.

Nigel Coe
Analyst, Wolfe Research LLC

Q

So, how is the – as you connect more devices, how is the nature of the service model changing? So, instead of break/fix, to what extent are we starting to get recurring revenues and getting that [ph] RMO (00:16:10).

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

A

Oh, it's much higher. I mean, this is kind of the new frontier for the aftermarket. It's not new to either our industry or the world, but it's a new-ish to Carrier. But we know that connectivity, it drives higher margin, higher – more revenue and more recurring revenue. So, if you take – I'll take Europe for an example for the Viessmann business. We have – we guide with our installer partners – we have [ph] We Care (00:16:37) with our homeowners. And what we can do is – it used to be that, because we have everything connected, a typical installer would make two truck rolls a year.

Now, they can get it down to one. So, now there's money savings in the system somewhere. How do you monetize that? How does Carrier, Viessmann monetize that? You do it through more recurring revenue type agreements. So, if we do more subscription-based agreements, then the avoidance of cost benefits all of us, less cost to the installer because they're not sending trucks out to a home just unnecessarily as a preventative prophylactic measure. But it's also a benefit to us because we get to monetize it.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. Thanks, Dave. Patrick, so you're committing to 50 basis points or more of margin expansion. Obviously, that came up in the Q&A yesterday. It sounds like that's a level you feel very, very comfortable with, that 50 basis points-plus. Maybe just recap us on some of the productivity initiatives in place. You talked about material productivity. You talked about platforming – technology platforming reduction and then investment level. So, I just wonder if you could maybe just talk about some of the push and pull on margins going forward.

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

A

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The reason we dug a little bit deeper yesterday in our productivity opportunities is frankly because we wanted to send a message that while we've driven a lot of productivity since the spin, there is a lot more to be had. And yesterday, we talked – we shared a little bit more detail about our Carrier Alliance Program with our biggest suppliers. Still opportunity to consolidate suppliers. We talked about factory productivity, reducing the time it takes to produce a unit. Again, there – we see significant opportunity there.

We talked about warehousing and logistics, and I don't think we ever spoke frankly publicly about warehousing and logistics, but it's about $2 billion in spend and it's an opportunity for us to basically optimize from a company perspective, whereas in the past it was optimized by site. And so, optimize the company lanes, optimize modes of transportation from a company point of view, and a much more robust SIOP process. Then, you mentioned platforming, and it's just one additional example of where there's plenty of opportunity.

Carrier was run in a very decentralized way. So, even within a business or within a segment, you could have duplicative investments in R&D. And so, now what we're doing is we're platforming, for example, on controls across the company, including transportation, just – not just HVAC. And so, we're significantly reducing the number of SKUs, reducing complexity, improving time to market. It only has benefits. And so, an enormous opportunity for us. And the message we also wanted to send is some of these benefits are not going to happen tomorrow. We'll see some benefit tomorrow. They're going to build up over time, and that's why we're comfortable saying that we'll see continued strong productivity for many years to come.

In terms of investments, since the spin, you can think of us making incremental investments each year of about $100 million to $150 million. And while we've done that, we've generated strong margin expansion, strong core earnings conversion. And so, going forward, we can easily continue to make those incremental investments at that rate if we have room actually. Frankly, if we grow 6% to 8% at 50 bps or more margin expansion, we could actually reinvest more. It would all depend on do we get the return on these investments.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay.

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

A

That is key.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Maybe a couple more questions just emanating from the Investor Day before we move on to more sort of current affairs. There might be a tariff question. I do [indiscernible] (00:20:13) on that. Thinking about – sort of the median multi-industry company right now has EBITDA margin of about 20% roughly. That's increased from high-teens several years ago. Best-in-class HVAC would be high-teens, 20%. Do you think there's any reason why over time the HVAC sector, yourself included, can't be above 20% EBITDA margins?

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

A

I don't because today our outlook is for operating margin to be at about – between 16.5% and 17%, add a few points of that of D&A, continued opportunity for margin expansion. I don't see any reason at all why, over the medium-term, we cannot get to 20% or more EBITDA margins.

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Nigel Coe
Analyst, Wolfe Research LLC

Q

Right.

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

A

Yeah.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Yeah, great. And then, on the surplus capital, you talked about $10 billion over and above dividends over the medium-term.

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

A

Yeah.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Seems like that's a five-year view.

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

A

It is.

Nigel Coe
Analyst, Wolfe Research LLC

Q

That's a five-year view?

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

A

Yeah. It is.

Nigel Coe
Analyst, Wolfe Research LLC

Q

But then, you mentioned $14 billion, keeping leverage constant.

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

A

Yeah.

Nigel Coe
Analyst, Wolfe Research LLC

Q

So, that obviously pricked my ears as well. So, is the protocol here that you basically will use free cash flow – surplus free cash flow for buybacks and then use leverage for M&A? I mean, how do we think about that?

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

A

The way we really think about the $10 billion of excess capital is this, we follow our priorities for capital deployment, organic growth, inorganic, a growing sustainable dividend, and then share repurchase. Now, that is a lot of capital just for acquisitions, and you heard Dave and I say yesterday that the acquisitions we intend to make are more in the bolt-on size. And so, I think it will be a combination of acquisitions and repurchases. And frankly, we'll toggle between the two depending on what the number and size of acquisitions is. I would not want you to think that the extra $4 billion, if we keep leverage the same, that that would just go towards acquisitions. It's the flexibility we have, and we're very comfortable keeping our net leverage at about 2x.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Okay. And then, when you think about the bolt-ons, Dave – I think this is for you – where do you see the white spaces in the portfolio? Because just from the outside in, it doesn't seem like there's a whole lot you're lacking right now.

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

A

There's really not. I mean, if you look at our pipeline, it's in the three categories that we focus on strategically. So, in the product space, there could be some technologies that, instead of just organically developing on ourselves, that we would just go buy. So, for example, Ed Dryden yesterday mentioned Addvolt, which give us a lot of power control electronics, which is not only very important for our reefer business and the electrification that's happening there. The same technology is going to be used on the HEMS side as well. So, we could have developed it. But they had phenomenal technology with a great team, a great group of engineers. So, we bought that.

The same could have been true for liquid cooling for our system solution. We did look at buying some of the smaller liquid cooling companies. But we decided the key thing that we needed to develop was the CDU, the coolant distribution unit, which is effectively a mini chiller. So, we said, we know exactly how to do that. We can either – and the multiples people were looking for were a bit higher than we wanted to pay. So, we just organically developed it. We have it. We're now in the marketplace with it. So, it can be technology, it can be channel. We bought some of our branches for the ALC business, some of the distribution channel. Those have done very, very well. So, we'll continue to do those. Same on the commercial HVAC side, where that makes sense. And then, things that we kind of need to round out our systems portfolio or even aftermarket like a services company.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay, great. I'll take one or two more, and then I'll open up the Q&A to the room. Maybe keeping it a bit more current, we're sort of halfway through the quarter, Dave, Patrick. What are we seeing? Anything – any big changes in demand across the geographies or anything you'd call out within the businesses?

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

A

No, not really, Nigel. I think what Patrick said yesterday is no new news, and that is true. We're fundamentally tracking to where we said. What we will look at every single month in a short cycle business, there are some parts of the portfolio that might be a little bit better, a little bit worse than we thought. But frankly, everything is right where we thought it was going to be just a few weeks ago.

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Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. You called out pockets of inventory builds, I think, in residential. Is this something to be worried about or is this more a function of the transition from R-410A to R-454B?

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

A

I think it's more of the latter. I think it's just – there's the industry is just, I think, playing out how this transition happened. So, if you look at us, for example, we had a very strong first quarter. We were up 20%. As we got towards the end of the first quarter, we had effectively transitioned out of R-410A quicker than our peers, because they obviously – a couple of our peers in particular ship more direct from their dealers. We ship through distribution. So, pretty much everything that was R-410A was out of our – is effectively out of our four walls. They were still shipping. So, what was happening in the channel was there were some switchover that was happening from the R-410A to the R-454B, which I think did create a little bit of elevated inventory.

We said on our last earnings call, inventory was higher than we would like it to be. We're very purposeful at working with our distributors to get their inventory back to where they – we think it should be in balance. So, we are working our way through that. We said that 2Q for resi would be up 15% to 20%. We still feel like that's the right number. But we are trying to do is bring inventory down. If you look at our full year guide for resi, we've said high single-digits to low double-digits. So, call that 10%. First quarter was up 20%. Second quarter up 15% to 20%. To get to 10% for the full year, you need the second half to be flattish, and we get probably 10% by showing up, because we know that we've been getting R-454B pricing in that 10%, maybe even a little bit higher than that. So, that means volume in the second half has to be down, and that factors in all the inventory that we're keeping an eye on.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. And that 15% to 20%, so if we think about the movements at the – at your channel partners, the sell-through, that would be flattish, I guess, flat to maybe low single-digits when we back out price/mix and inventory?

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

A

Yeah. That's the balancing act we're looking at right now, Nigel, is we're looking at inventory. We're looking at those movement levels. We're looking a little bit at ordering rates. But I'm not – that's not something that we're going to – if it's super positive or negative, it's going to keep us up at night. The key for us right now is really watching those movement numbers. We saw what they were in April, watching them here in May, and making sure that movement stays strong and then the inventory gets out of our dealers to the homeowners to see that pick back up.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Thanks, Dave. Any questions from the room? There's one here. Do we have a mic?

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

A

Oh, I have a mic.

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Nigel Coe
Analyst, Wolfe Research LLC

Q

Yeah, right here.

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

A

I'm sorry?

Q

Hear me?

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

A

Yes.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Yes.

Q

I was just curious if you could comment on your end markets for commercial HVAC in terms of are any of them currently at a cyclical peak such as data centers, education or any other end markets? Thank you.

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

A

I would not call a peak for any of them right now. I think when we look at our verticals, we see some that are stronger and some that are weaker. But I don't – we don't see a peak. Data centers, we did $500 million of sales last year. We'll do $1 billion this year. We're trying to fill the pipeline of orders for the coming year. So, different hyperscalers are buying at different rates. Same with the colos. But we certainly don't see a peak there. The areas of strength are things like semiconductor fab, not only in the United States but globally. We've had some great wins in China, for example.

We see healthcare globally – typically an aging population. So, hospitals, and we see pharma has been quite strong for us. So, that's been good. Some of the – higher ed has been good. K-12 was a little bit weaker in the first quarter than we thought. But we think that's sort of short-term. We don't see that as a concern, because there's $76 billion of bond funding out there for K-12. So, we just see that as a timing issue. Some of the things that were weaker, commercial real estate has been soft and it continues to be soft, and I think that's generally it.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Thanks for the question. Anyone else? Great. Maybe, Patrick, tariffs. Obviously, since you reported the quarter and you sort of updated – you have refreshed your guidance. We've had China tariffs roll back. I think you

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said yesterday, nothing's changed with the $300 million of net offsets to the tariffs. So, just maybe just talk about why that's the case, because it does feel like you've got a bit of a cushion here?

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

Yes. So, first of all, in terms of context, we mentioned that with the tariffs, we – it was a gross impact offset by some supply chain actions. There was a net impact of about $300 million, which was offset through incremental prices that we have put through. One – the reason why I said nothing has changed for the moment is one, it's still really early. Who knows what will happen. Two, it's not like we haven't seen other pockets of price increases in the system. And so – and that's really the reason why I made the comment. It's still an environment where a lot of things move really fast, and we are seeing some pockets of other price increases. And so, we may need the $300 million anyway to cover that.

Nigel Coe Q
Analyst, Wolfe Research LLC

Okay. And the price increases you put through the channel...

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

Yes.

Nigel Coe Q
Analyst, Wolfe Research LLC

...how would you describe those in terms of acceptance by the customers in the channel?

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

For the moment, they're all holding.

Nigel Coe Q
Analyst, Wolfe Research LLC

Okay.

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

The last one went into effect May 1.

Nigel Coe Q
Analyst, Wolfe Research LLC

That's good news. But as a customer of Carrier, that's not good news, because I do feel that as somebody doing replacements right now of Carrier systems, it is a lot.

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

But your home is really comfortable though.

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Nigel Coe
Analyst, Wolfe Research LLC

Q

It feels good. I got to say that. Europe...

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

A

We appreciate the business.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Europe, I think you're guiding for – obviously, it was down low-doubles in the first quarter.

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

A

Yeah.

Nigel Coe
Analyst, Wolfe Research LLC

Q

You're guiding for flat in the second quarter and then a return to growth in the second half of the year. Maybe just bring us up to speed in terms of what you're seeing right now in Europe and the confidence levels in that inflection.

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

A

So, the reason why we expected and we saw a weak first quarter was frankly because last year, we benefited from a significant backlog reduction. And so, we fully expected Q1 to be down about 10%, which it was. We expect flat to modest growth starting in Q2 for a couple of reasons. One, the comps get a whole lot easier. And two, we're seeing some early, but positive signs of a market that is stabilizing and an increase in the number of applications for heat pumps. And we've seen actually the order intake for heat pumps pick up quite substantially.

In addition to that, I think it's fair to say within our biggest market there, which is Germany, with the new government, I think there is more stability now than we've seen over the last six or nine months. New government is formed. New government has kept the incentives, has committed to lowering the cost of electricity which is good, has also committed to more infrastructure spend. And as importantly, the new government has also committed to the decarbonization goals for 2030 and beyond. And so, overall, we think the market is – we're cautiously optimistic. We certainly don't think the market will get worse. But actually, we see signs that it may improve.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. Maybe just talk about why we're seeing the strong recovery right now in heat pump orders in Europe, not just Germany, but in Europe. Is it because we're at a hard floor here and then we're just bouncing off a very low level? Or is it anything else we should bear in mind?

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

I think what's happening in Europe is you will see an accelerated shift to heat pumps, because I think there's a reluctance to buy fossil fuel right now. When you think about Europe, only 10% or so of the gas that's consumed in Europe is produced in Europe. And I don't think a lot of Europeans want to be overly reliant on importing gas from Russia, the United States, the Middle East. So, I think you're going to continue to see an accelerated shift to electrification. I think the government in Germany – the shift to reducing electricity prices, that will bring that ratio of gas to electricity – electricity to gas significantly lower, which is very helpful.

So, you have this combination of electricity pricing coming down, especially in places like Germany and France, which is nuclear and so on, and then you have the increased taxes that we're going to see on gas. So, gas going up, electricity coming down, that ratio mix is very helpful. So, we said – when we said that we would get 3 to 4 points of growth in our RLC business, that is from mix. That assumed heat pumps up 15%, boilers down 5%. I think what we're going to see this year and then probably for the coming years, heat pumps will probably be higher than 15% and boilers will probably be down more than 5%, because any new home – like your new homeowners are really – they were trying to figure out what's happening with subsidies, what's happening with regulation, and they're really – I think you're going to see an accelerated shift to electric heat pumps.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Thanks, Dave. Back to margins, Patrick, you've got a target of 15% on the medium-term. You said two to three years to get to 15% margins in Europe versus 9.4% last year. And it seemed to me that you're indicating that, look, we think we can do better, but let's get there first before we move on. But is there any structural reason why we should have a big gap between the Americas at 22% and Europe at 15%?

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

I think we'll see the margins converge over time. I think – and of course, the objective is to get as close to and exceed the US margins. But in the United States, we really benefit from a really large country, homogeneous, where we have tremendous scale, and we are the – we believe we have the market – the leading market share. And so, we'll see them converge. We'll of course have asked the team in Europe to get as close to or exceed – like a horse race, to get close to the margins in the United States. But what we wanted to share yesterday that our step one is to get to mid-teens. Given that we're at 9% today, that alone is a big [ph] jump (00:35:04).

Nigel Coe
Analyst, Wolfe Research LLC
Q

Okay. And then, we got one more minute – actually 40 seconds. So, in the last minute or so, maybe just – Dave, just recap what is Carrier's strategy in data center, because it does seem like you're trying to knit together something quite special here?

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

I think it started with winning the trenches, which was add capacity, make sure we have the product portfolio that we needed to build, make sure that we have the right customer relationships with the hyperscalers and the colos, the right sales force, the right dedicated and integrated product management team. So, we've done all that, and because of that, we've gained a lot of wins and gained great positions with both colos and hyperscalers. The next

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phase is differentiation, and that is going to come, I believe, through our QuantumLeap offering, which is a one-stop shop with this integrated offering.

Nigel Coe

Analyst, Wolfe Research LLC

Right. Okay, Dave, well, thanks for the time. Patrick, thanks for the time. This is a great discussion, and we'll look forward to catch up with you soon.

David L. Gitlin

Chairman & Chief Executive Officer, Carrier Global Corp.

Thank you, Nigel.

Patrick P. Goris

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

Thanks for having us.

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