IngersollRand

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Julian: Good. So time now for Ingersoll Rand. My pleasure to have here Sue Carter, CFO and Dave Regnery, EVP. We'll go straight into Q&A. I think the first topic, or the most recent topic has obviously been the acquisition of PFS, so maybe give us some background, Dave or Sue, about how long you've been following that asset. What kind of process there was around the transaction and why you felt that that business, fluid management, was the most logical area for a large deal right now?

Sue Carter: Let me start out with my experience and then we'll let Dave add his experience on Precision Flow Systems. So this is an asset that we were tracking before I got to Ingersoll Rand and in fact the company was looking at the asset as a strategic acquisition or pipeline candidate back when it was taken out of United Technologies, I believe it was 2012. So this is something that we've tracked, it is a business that is very complementary to our fluid management business and we've talked about being that an area where we wanted to invest in for a number of different reasons.

But it's been on the pipeline for a number of years. It hits all of the financial criteria. So it's a great business with high EBITDA margins, great products, good geographies. A lot of things that hit all of our metrics in terms of the culture of the business, the processes within the business, as well as the financial metrics. Again, they generate about 100% of net income on cash flow. Their CapEx is very similar to ours at 1% to 2% of revenue. Their investments in the business in R&D are a couple of percent, so very complementary to our fluid management overall. And so hit all of the metrics and we were really very, very pleased that as BC and Carlyle sold out the asset that we were the ultimate winner. And Dave, do you want to talk about the business a little more?

Dave Regnery: Yes, you ask how long we've been following it for. I actually had the opportunity to run that business back in 2007, so --

Sue Carter: Our business.

Dave Regnery: Our business, the ARO business. But we were looking at PFS back then. So it's a great business, technical sell, complements our ARO business. Basically zero product overlap. Just gives us a lot more scale on a global basis and we're super excited to have this as part of our portfolio.

Julian: Then if we think about next steps on M&A, you sort of equally balanced in terms of preference across the climate and industrial businesses?

Sue Carter: I think its -- Julian, the way I would answer that is it's a best idea with the greatest return. So does it fit in the strategy first of all? And then is it something that is a technology, a geography or an adjacency to the businesses that we're in? But we're really agnostic as to whether it's on the climate side or the industrial side. We're going to continue to invest in the channel and technology on the climate side, as well as we've still got a pipeline of ideas across both of those segments.

Julian: Understood. And within HVAC you've had a fantastic 10-year period almost now of market share gain, largely organically and then some partnerships such as Mitsubishi and VRF technology. If you were thinking about HVAC consolidation, what types of attributes would appeal? Because again, it looks like organically you're doing everything you need to do on building out share.

Sue Carter: I would start out by saying what we've been saying for a while, which is that in terms of HVAC consolidation we don't need to do anything. We've invested in our business, we're in a great spot with our customers, our products, our portfolio, and our distributions so we don't need to do anything. I think as you think about it, there is an opportunity for synergies, but any combination in the HVAC space is going to have some hair on it. So in other words, there's going to have to be divestitures and there's going to have to be other items and so we're extremely fortunate that we've got a great business and we don't need to accomplish anything if there's consolidation going on.

So if others consolidate, we'll continue to run the business operating system and run like we have been and just keep going with the great performance that the business has had. I mean I don't know very many businesses that had 13% organic bookings growth in 2018 and 9% organic revenue. And just FYI, 29% EPS growth. So it just is a fantastic business and we don't need to do anything.

Dave Regnery: Yes, and we'll continue to add on as we have in the past in our channel, especially on the commercial side. We'll buy up the independents that are still out there, so that's a strategy that we've had for over that 10-year period and that will continue.

Julian: One interesting point organically I guess recently in the climate business was the very large order that was booked in the fourth quarter. I think close to $200 million or so. It sounded on the call as if you felt that that type of project may become more common. So maybe explain why you thought that, were there any regions in particular you had in mind or end market verticals?

Dave Regnery: I'll start, Sue. I mean first of all, it's a great order. I would tell you that we've been working on that order over two years, just so you can understand a little bit of the time to close orders of that magnitude.

Julian: Yes.

Dave Regnery: This particular order is outside of the United States. We're tracking orders. Really this is a global business when you get into the energy space, which is where this is. And we have

projects like this in the pipeline, but the gestation period is quite long on these and there's a lot of turns as you go forward with these projects.

But yes, energy is a -- I always tell people we have a great HVAC equipment business, we have a great HVAC controls business, great HVAC service business, but we're really an energy business because that's where we play. And if you think about it, with 40% of all the energy coming from buildings, and we're able to go in and depending on the vintage of equipment, save a customer 30% to 50%. That's why it's such a compelling business opportunity. And if you get into these larger scale projects, they just take longer to close. But yes, there's certainly some in the pipeline.

Sue Carter: We have line of sight to these things, as Dave said, for a couple of years, but we don't put them in our operating plans. We don't put them in our guidance because you just really don't know when they're going to close, but they're great projects and we are always going to be very, very transparent that that is a part of the bookings number that's in there. The bookings number was phenomenal without the $200 million order also in the fourth quarter, but we're going to give you the comparisons and we're going to give you the visibility to that because they are large and they do have year-over-year impacts. But they're great projects and they just take a long time to close the original transaction and then this one happens to be a 40-month period from start to finish when it will all book into revenue.

Dave Regnery: It's a 40-month burn period till it's completed, but understand that on the backend of this will be a service agreement that will be a long-term service agreement on this project.

Julian: How much, on that point, Dave, how much of the -- I think you sort of characterized it as in Trane non-res about 45% or so of the sales of service are off after market right now.

Dave Regnery: Depending on the region of the world. It could be more, but yes.

Julian: So globally I guess, how much of that portion is sort of long-term service or contractual service? Roughly or -- and how is that rate changing?

Dave Regnery: You look at service, there's a couple ways we look at it. One is break fix, means the customer just calls us up and says my unit is down, can you help me out. We also have many different types of service agreements though. And those service agreements could be as broad as we become the insurance company. So anything that goes wrong with your equipment is -- we'll keep you running and we usually have -- there's usually time horizons as to how quickly you'll respond and get them back up and running. We tie that in to the agreement. Two, we'll supply parts and components as needed.

As far as the percentage of our business that's under contract, it’s north of -- and remember, these contracts typically are less than three years in nature. Most of them are less than a year and they get renewed. It's probably in the 40% range.

Sue Carter: Correct.

Julian: Of that…

Dave Regnery: Of the total.

Dave Regnery: Yes.

Julian: Okay.

Dave Regnery: And really what happens too is when you have a break fix customer, the objective is how you turn them into a contractual customer, right? Because then they understand the reason why they want to be able to have a service agreement, because they don't want the unit to be down. They don't want their physical environment to be interrupted.

Julian: I see. And what kind of profitability or ROIC implications does that contractual aspect carry?

Dave Regnery: Our service agreement is accretive to the bottom line and as you -- every one of our service contracts is accretive. It's a matter of what type of product the service agreement is on. Or is it on a campus and the size of that. But service overall is very accretive to our portfolio.

Sue Carter: And Mike often describes that as a business that has a higher gross margin and then the technicians are actually in the SG&A type of line. But it's still accretive to our overall operating margins as a business.

Dave Regnery: The neat thing about our service business is I always tell people that our service technicians are some of our best salespeople. They just don't know it. But they build credibility with the customer everyday and the more touch points you have with that customer, they're on the jobsites, they understand what's required. There's a lot of pull-through that they actually create of other services that we offer them. And that could be even on the energy side.

Julian: How much sort of outcome based business is Ingersoll doing now in terms of climate and industrial. I think there's been some push towards, for example, in the energy management side. If you can deliver energy efficiency of X, the payback for you moves up.

Sue Carter: Should the performance contract have -- I don't know how much of it is of the total base at this point, but.

Julian: But is it something that's growing sort of...

Dave Regnery: Absolutely it's growing. It's a focus area. I think that if you talk to an end customer, and by the way, our whole strategy there is about account managers that are direct. The more contact you have with the end customer, the more contact you have with the engineers, the more contact you have with architects. You're able to influence that sale and explain the value proposition of an outcome sale. So when you go into a building like this and you say 'what's the energy consumption, what's the lighting look like, what's the vintage of your equipment, what do your controls look like. I could guess just by sleeping here last night that we could probably have a big impact on the energy consumption of this building.

Julian: Right. We'll have to leave some space at the end of the day for you to walk around a bit.

Dave Regnery: I'll have to go downstairs and look.

Sue Carter: We were almost in the boiler room.

Dave Regnery: I was in the boiler room a while ago.

Julian: And on the industrial compression side, service has also been an area of focus there. I think it's one of the reasons why Ingersoll likes that industry so much. So maybe give some kind of update on the aftermarket drive.

Dave Regnery: The outcome based on the industrial side is -- you think about the energy consumption of an air compressor, that's important. When you think about the whole air distribution system than an air compressor is attached to, that's more important. So if you've been to a factory and you think about all the points of distribution and all the possibilities of leaks to occur, being able to detect that, being able to model that, being able to remotely diagnose that, that's a big opportunity that we're working on there. And we have great solutions for that.

Julian: And on the energy controls in buildings, it seems as if that was built up largely organically. So maybe give some backdrop as to -- I think it's something that other companies perhaps in the HVAC world could have done that didn't.

Dave Regnery: Well I mean we've always had a building control business, certainly since Ingersoll Rand has owned Trane. When we started the investments in our Trane business, the ones that became most visible were the equipment investments. But I would tell you that at the same time we were investing as much in our building controls as we were in equipment. In fact, we were investing more in our buildings controls. So it's always been there, but we've invented some really neat solutions, especially when you start talking about wireless controls and being able to offer lifetime warranties on batteries and those wireless controls and the meshing that occurs and the repeats. I mean we've made building controls easy for contractors. And that's a big point as to why we've been very successful in that space.

A lot of our offices now will only specify wireless controls and I think if you go back seven or eight years ago, that wasn't even in our portfolio. So we've really advanced that. And by the way, we have more new products in the pipeline in that space and we're going to continue to invest there. And then you connect that together with energy, obviously the energy solution story is relatively easy to understand and you get the account managers that are direct, they're able to sell that to the customers. You have technicians that have relationships. It's a network of things that have worked together quite nicely for us.

Julian: Got it. Maybe switching geographically. I think it caused some people some consternation 15 months ago or so to push into China in climate and on the residential. Now the volumes took off, but maybe carrying slightly lower sort of OE margin rate at the time. So maybe give us an update on since that initial burst how has the business in China developed? And the market's obviously a bit choppier. Maybe some thoughts on that, but also just Ingersoll's own market share push.

Dave Regnery: First of all, we're very happy with our performance in China. We went first, I guess you'd say. We understood the fact that the market in the HVAC, the direct account managers being able to influence architects, being able to have products specified by engineers, developing relationships with end customers was extremely important in the selling process. We took that concept to China and basically over a short period of time, over two years, have added over 300 account managers. And we didn't disrupt the existing distribution that was in China, we augmented it with our direct sales force.

So now yes, it was an investment and it was investment for how do you get the installed base? How do you get more coverage? How do you ensure that you're able to not only have that installed base, but tie service agreements to that? And what we're seeing now is we've executed as we've originally designed the system. We've built out the account managers, we're seeing the, what we call the linkage rate to service as we have more of an installed base and you could see our growth rates in Asia versus others, specifically in China. And I would say that we're very successful.

Sue Carter: Yes, and I think Julian, when you think about it, first of all our business has been growing much faster than the end markets, which is also a big plus for us as we look across that. And so when we do our reviews with the business and we're looking at well, tell us exactly which end markets and kind of all of them. And so they're playing broadly.

This is also one of the businesses for us that has a low cost base. It's a very conscientious team that is focused on all of our core values with productivity, with driving operating margins and leverage and driving cash flow in the business. And so all of this, while it's been a journey, as you pointed out, has been great growth and their margins are going up over time and they will continue to go up as we operate the business.

But it is good growth, it's good leaders. We don't have a bunch of expats sitting in China. We have local teams that understand the local markets. And I know that this wasn't necessarily the question, but as we're looking at our manufacturing, as we're looking at our supply base, we're in region, for region and the fact that we have local teams that are operating those businesses, it all goes together to make a good business, a profitable business and one that's continuing to grow.

Julian: And China margins, I think as you said, there was a sort of a headwind on reinvestment 12, 18 months ago, but your margin --

Sue Carter: But they're coming back and they'll continue to grow. Yes. They have the same leverage expectations as the rest of our businesses and they have great plans to execute that.

Julian: One question may be on the US HVAC cycle, if you like. Any thoughts on residential replacement? Some of your peers think it's a sort of a somewhat scientific question, others think it's completely an art. Wonder if you had any perspectives on that residential?

Dave Regnery: I'll say it's both, okay? We predominantly play in the replacement market, as I think most know. We see growth in 2019 and we see ourselves continuing to grow faster than the market. I mean I think there's some factors that are maybe playing into it, which makes it a little more scientific and that's the fact that you had a refrigerant change that happened seven or eight years ago that the cost of that R22 refrigerant today versus conventional

refrigerants 410A, which what's being used today is dramatically different. So you're talking $80 a pound versus $5 or $6 a pound. So that's adding to the replacement market, meaning that if you were going to get your unit fixed, and you realize that you're going to pay an extra $500 for refrigerant, you may make a different choice. So it is accelerating a bit of the replacement market. And there's still a lot of R22 units that are installed across the United States. So we see the replacement market continuing to be -- show growth, and we like what we're seeing in our residential business.

Julian: How about on institutional and commercial?

Dave Regnery: Institutional, I think if you look at it as a broad category you'd say it's going to have growth in 2019. If you dissect it a little bit, I think you're going to see strength in education, K-12 and higher ed. And I think higher ed, you're going to see a lot of opportunities in the energy space as well. As far as healthcare and government, they're going to -- I've been waiting for 10 years for healthcare to come back, so one of these years I'm going to be able to say that.

Julian: Right. It's fairly early since it closed, the Mitsubishi relationship on VRF technology. VRF's an area where assumptions have moved around a lot in the US on uptake and penetration, depending on which OEM you talk to. Maybe give us some thoughts on how you see that VRF market growing medium term in the US. What verticals you're most excited about penetration.

Dave Regnery: I'll start with we're very happy with our joint venture with Mitsubishi, so we're very happy with the results that we've seen. As you said, Julian, it is early days, but we're very happy.

If you look at the VRF market, about four or five years ago people were talking about growth rates in the 20% plus.

Julian: Yes.

Dave Regnery: I think that's moderated. I know that's moderated. It's between, depending on how you're counting, $750 million and $800 million market in North America. We see it -- it'll be growing, it'll be growing at a faster pace than the market, but that's starting to get muted.

VRF is a neat technology. It's simultaneously heating and cooling, so it's an efficiency play. It's not for every application. So what we're able to do with our breadth of portfolio is we can take VRF solutions and comingle it with conventional systems and really come up with unique opportunities to solve problems for customers. It's not for everyone, but there are applications where you would use VRF and there's niches within applications that we're using VRF.

Sue Carter: And I think it's interesting, Julian, could we talk about early days? It's actually coming up on a year. And I've had the opportunity several times to look at the business case and how we're doing, as well as how the business is performing. And it's on track, the teams are engaged, they're working very well together. So this isn't a JV where you're butting heads or you're trying to figure out how to work together. It's actually working very well. It's hitting the business case metrics, and like I say, it's coming up on a year, so it's kind of interesting. Time flies.

Julian: And then one of your peers yesterday in HVAC sounded sort of cagey around European demand. Is that something you're seeing? Or it depends country by country and the broad brush is fine.

Dave Regnery: I would say that if you look at the European market, it's probably flattish, maybe low single digit growth. I think if you look at our -- I think our growth and success in Europe isn't really about the market, it's about our portfolio of products that are -- the vitality rate of our products in Europe are some of the best we have in the company. So our entire portfolio is new there in the last four years. What that team's been able to do with next generation refrigerants, what they've been able to do with VRF type solutions, but with chillers as a product they have. It's a four-pipe chiller. How they've expanded that market. How they've grown their service business. We anticipate that we're going to continue to grow at a rate higher than the market in Europe and I'm very confident in our business there in Europe. Sue, I don't know if you want to --

Sue Carter: Yes, I mean as you were talking, Dave, I was thinking about Dave and I and the team had an opportunity to spend some time with our leadership over the last couple of days. And one of the things that we've built at Ingersoll Rand is a really good management team that has a lot of capability across the globe. And these are energized leaders. They are just -- they follow our business operating system, they are into the markets, they're into the details and they're really, really engaged in what's going on.

And Europe is absolutely one of those areas. Jose is just a fabulous leader who just loves this stuff and it translates into having the right products and having the right ability to grow within the markets and grow faster than the markets. So like I say, I think there is a hallmark across Ingersoll Rand with the leadership capability that we have in each of the regions around the globe as well as at the corporate center. And I think we've built something pretty special with the management team, as well as with the business operating system, and it shows every time you ask a question in one of those areas. And like I say, it makes you smile when you think about those leaders.

Julian: And then maybe the truck market in the US, you've finally seen, after years of expectation, that the Class 8 order's coming down now. When you think about Thermo King's sort of sensitivity to that, any impressions or --?

Dave Regnery: Go ahead, Sue.

Sue Carter: Well I think the biggest thing to start with is the fact that we've built a different ThermoKing over the past several years, a diversified and resilient business so that it isn't just about North America trailer. The growth of auxiliary power units, the growth of the business in Europe and some of the other markets has really made a tremendous difference. In addition, we've had an incredible year in terms of the growth in the North America trailer refrigerated units, as well as the auxiliary power units, that I'll let Dave, you talk about. But it's really important to think about it's a much more resilient business that's less cyclical because of the other products and advances that we've made in the business.

Dave Regnery: The business is much more diversified than it was 10 years ago for sure. I would tell you that Thermo King is the business we talk about having a very robust backlog as we go

into 2019. Thermo King has the most robust backlog. So we have good visibility there as to what's going to happen and certainly for the next six months plus. So we're pretty confident in our business in Thermo King. And if you look at the end markets too, ACT which is what they use on the market side, they're having an increase again in 2019.

Julian: Yes. Good, well I think we have to switch now to audience response survey questions. So the first question is do you currently on Ingersoll Rand stock. So about the same no's as the last few years.

Number two, please. What's your general bias to Ingersoll today? So broadly positive, similar to recent years.

Number three, please. How do you think the through cycle earnings growth will be relative to peers? A lot more above peers than prior years.

Number four, please. What should Ingersoll do with excess cash? So mostly buybacks.

Number five, please. What P/E multiple on 2019 earnings should Ingersoll trade at? Some high teens.

And last question, please. If you're one of that 75% who don't own the stock, what's the main reason why? Early balanced.

Sue Carter: Yes, nice even spread.

Julian: Capital deployment's not the question, but.

Good. Well we're out of time unfortunately. Sue and Dave, thank you very much.

Sue Carter: Thank you, Julian.