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Trane Technologies (Ticker TT)

COMPANY PARTICIPANTS

Dave S. Regnery - Trane Technologies, Chair & CEO

Christopher J. Kuehn - Trane Technologies, CFO & EVP

OTHER PARTICIPANTS

Andrew Kaplowitz – Citi, Managing Director

Andrew Kaplowitz

All right. Welcome back, everyone. We are very excited to have Trane Technologies with us today. We've got to Dave Regnery, who's the Chair and CEO; and Chris Kuehn, who is the EVP and CFO with us.

Question – Andrew Kaplowitz: Dave, as I walk over here maybe I'll just ask, you've been at the helm of Trane for almost two years. I know time flies when you're having fun. Can you talk about what if anything you've changed regarding Trane strategy over the last two years and reflect on what maybe you're most proud of and what if anything Trane could still improve upon as we go into 2023?

Answer – Dave S. Regnery: Yeah. Thanks. It's hard to believe it's two years, so time flies...

Question – Andrew Kaplowitz: Time flies.

Answer – Dave S. Regnery: ...when you're having fun, right? So, look, when I took over as the as the CEO and the Chair early on, I said, look, I've been fundamental to the blueprinting of Trane Technologies as a pure play climate innovator. And this started this transition between Michael, Mark and myself started well before it was announced. So, I said don't expect a lot of dramatic changes to our strategy and hopefully you haven't seen these dramatic changes that sometimes you see when a new CEO gets named.

But what you have seen is consistent performance and being able to execute at a very high level and our business operating system enables us to do that. And I always tell people it's a system of things that makes Trane Technologies a great company. And I could talk about innovation, I could talk about a lot of things, but I always start with our culture and that's what allows us to differentiate ourselves as Trane Technologies and I'm very proud of the performance that we've been able to demonstrate.

In 2022, organic revenue was up 15%. Our EPS was had a growth of 21%. Our book-to-bill in the year was 109%. We exited the fourth quarter with a record backlog of close to $7 billion. We have a very strong guide for 2023. We have – I could go on and on about how proud I am of what this team has been able to execute. But it's been a – it's been a great two years. I am a little bit flabbergasted when people remind me it's been two years because it seems like it was just yesterday, but I'm having a lot of fun.

It's funny. I always had – it's a funny story, but I was at a – in Charlotte, we have a group of CEOs that get together periodically and it's really all about how we could create economic mobility in the Greater Charlotte area. And there's a lot of CEOs of publicly traded companies that are in Charlotte. And I was with this group and we were having a break and we were just talking amongst ourselves. And one of the fellow CEO said, boy, the last two years have been the hardest I've ever experienced as CEO. And I'm thinking to myself. I wonder if my job is going to get easier because these have been the first two years of my career. So, anyways, it's a great job. I think the team is executing at a very high level. And hopefully, everyone here sees that in our results.

Question – Andrew Kaplowitz: That's great to hear, Dave. So, like, maybe I'll just ask you, you kind of mentioned this a little bit. I think Trane is one of the most innovative, if not the most innovative, of the global HVAC companies, but the megatrends to make sure you stay at the forefront of innovation.

Answer – Dave S. Regnery: Yeah. I mean, this is one of those – part of that system of things that makes us a great company, right, is innovation and we relentlessly invest in innovation. This isn't like a flash in the pan. We're not going to be episodic. We're going to be very consistent about how we execute or how we invest and then how we execute, right? Because it's not just about the dollars you invest, it's the process that you have behind that. And we've been able to really hone that process over a long period of time. I would tell you one of the things that I always point to that differentiates a little bit us versus some of our competitors is the fact that when we go at innovation, we're always looking at a system level. So, we're not out there at a component level or a product level. We're always thinking about the system of HVAC and what's that solution look like.

And if you look at – I'll use Europe as an example – where a traditional way to heat and cool a building is that you have a chiller plant and you have a boiler plant. And our clever engineer said, wait a second, it's HVAC, heating, ventilation and air-conditioning. Let's look at that system and how could we combine that system. And now we have a thermal management system that basically eliminates the need for fossil fuel, for heating in buildings. It's all electric now. You do not need fossil fuel to heat a building. You do not need it. And we have that technology.

And think about 15% of global greenhouse gases from heating and cooling of buildings. And most of that comes from heating. If we could eliminate fossil fuel from heating, we would dramatically change the landscape on decarbonizing the built environment. And this technology exists today. It's not like we have to wait, right, I know the world is getting warmer. And it's just – so I'm very proud of what our team's been able to create, expect more of it in the future. It's not just on our Trane, so I can talk about Thermo King and get just as passionate about some of the inventions we have there and what we're working on with electrification and how we're continuing to push the envelope to make sure that the planet that we all live on here is better for the next generations that are going to be here.

Question – Andrew Kaplowitz: Trust me, Dave, we're going to get to those things. So let me just step back, though, and ask you about the current environment for a second if I could and maybe Chris can chime in. Last quarter, you reported -with all the strength, you still reported flattish bookings, which again is a very tough comparison, but you go into 2023 with record backlog $7 billion. You talked about ending this year with $6 billion of backlog. So are essentially telling us that there's still a good chance you have multiyear earnings visibility here and how resilient do you think earnings growth will be when we start seeing these leading indicators come down with the ABI or Dodge momentum?

Answer – Christopher J. Kuehn: Yeah. Andy, why don't I start and Dave can jump in. Look, I think it's really important to focus also on the absolute dollars because those tough comps, as you mentioned. 2021, we saw 27% bookings growth for a full-year basis. Fourth quarter, we had $4 billion of bookings. We had revenue of $4.1 billion. And so, while you look at the revenue growth of 15%, the backlog really didn't move much in the fourth quarter. What we tried to do for 2023 is we said, okay, if we look to the end of the year, we expect backlog to be probably $6 billion or stronger. Okay. We ended 2022 entering 2023 with $6.9 billion.

So a little bit of context around that. If we were to have flat bookings in 2023, okay, that's $17.5 billion. Based on our revenue guide for 2023, we would actually grow backlog by the end of 2023. It'd be over $7 billion. Our guide of a ballpark, as they call it, $6 billion or stronger, that assumes revenue or bookings decline of around 6%. So do we think that could occur? It could. But if we end 2023 going into 2024 with $6 billion of backlog, that's still 2 times the normal level of our backlog entering it in a year gives us a lot of visibility into the forward looking demand.

Question – Andrew Kaplowitz: Helpful. So let me ask you about – I think we talked a little bit about sort of innovation. Let's move to sort of pricing a little bit about sort of innovation. Let's move to sort of price – pricing of that innovation and price versus cost. You talked about 2% to 2.5% carryover pricing into 2023. What are your expectations for sort of driving additional pricing if you need to? I mean, as you know, copper's bounced, steel's down. So how do you think about that? And stepping back, you guided 25% organic incremental margin. How do you think about a contingency in that forecast if supply chain headwinds or inflation is worse than you thought?

Answer – Christopher J. Kuehn: Yeah, I'll start. Look, we feel really confident on our 2023 guide. I'll start there. We're not planning for really any inflation-deflation. We're kind of planning on a flat basis on a year-over-year basis, Andy. There are pockets of where we've seen costs come down. Certainly around logistics and freight, there have been some opportunities there. Steels retreated a little bit. But that pocket of savings or lower costs we saw third quarter, fourth quarter, early fourth quarter last year on copper, aluminum, to your point, those have bounced back, right?

Question – Andrew Kaplowitz: Yeah.

Answer – Christopher J. Kuehn: What we are seeing, though, we're also seeing a lot of inflation around wage and energy in our Tier 2. In this order of magnitude, our Tier 1 spend copper, aluminum, steel, it's around $750 million of annual spend. Our Tier 2 spend when you think about motors, compressors, metal fab, that's over $4 billion of spend. So when you start seeing the wage inflation. energy inflation on a much bigger base, that's why we bundle it all together, came out and said we think it's going to be roughly flattish on inflation/deflation.

We've got price increases that were put in place December, early January, and that's just based on our full year outlook for 2023. And we're targeting 20 to 30 basis points of price over cost in 2023. It's allowing us to do even further investments. We can certainly talk about that as well because we've got a great pipeline of investments. We want to keep that always flowing. But I'm really proud. Dave is too, around the business operating system that we've driven for pricing every quarter in 2021, every quarter in 2022, we were priced over cost on a dollar basis and the resilience of that operating system I think really shown through.

Answer – Dave S. Regnery: Yeah, Andy. I mean, the strength of our business operating system and right here we're talking about our product growth teams led by our product management teams, just exceptional performance that we've seen over the last several years. I mean, just think about the amount of inflation that we've seen and the fact that we've always been able to stay ahead of that. I mean, they look around corners and that's what we talk about, that's what I talk about when I talk to them is what are we seeing around the corner. So if we continue to see persistent inflation and I know we'll see if that happens. I'm very confident that team will be ahead of it.

Question – Andrew Kaplowitz: Chris, just to top on one thing you said, it's interesting right because it's like you've kind of going to more normalized year on price versus costs that 2023 is kind of what you usually do.

Answer – Christopher J. Kuehn: It is. It is. So, I hope the viewpoint in 2023 is we don't need to have three rounds of price increases like we saw in 2021 and we saw in 2022. But look, the business operating system is nimble enough that if we have to react, we will react to that. We are targeting that 20 or 30 basis points and I hope we get to something more normal. But it isn't just pricing for cost, right? It's pricing around innovation and we're always making sure we're looking at a total value to the customer. And when you think about our products that are more energy efficient, more less reliant on fossil fuels and the cost of those have only gone up. That's been an area that I think has been a lot of success in driving a lot of demand.

Question – Andrew Kaplowitz: And I know what you're going to say, but if demand were to slack and like if you look at residential for example, like you're not going to get that price or you think it's pretty sticky?

Answer – Christopher J. Kuehn: We think it's sticky. And the history in the industry would suggest that to me on pricing holds and sticks over that environment. Okay.

Question – Andrew Kaplowitz: Okay. So maybe just delving into some of the underlying end markets a little bit more, obviously, North America commercial HVAC, really, really strong market. 4Q bookings were plus low-teens. Revenue was mid-teens growth. So I know you talked about strength in a number of verticals, but how are you thinking about sustainable growth rates in sort of North American commercial? Do you expect any difference between applied in Unitarian markets and what end markets do you think will be the biggest driver of growth in North America?

Answer – Dave S. Regnery: I think the verticals that I called out on our fourth quarter call will continue at least in the mid to long- term. I mean data centers are going to continue to grow. What we're seeing in the education with some of the stimulus funding that's happening there with ESSER, that will continue to be with us for the – really, I mean, now they've extended that. So I guess if an order is accepted by September of 2024, you have to 2026 to get it installed. So that will continue to be.

I think we're seeing – in the high-tech industrial space, we're seeing certainly nice activity there. Think about battery plants for electric vehicles, a lot of cooling capacity required. I think in front of us that we haven't yet seen is things like IRA once those funds start to move forward and that will impact both residential and commercial, as well as the Chips and Science Act, that'll be another – that's a little bit further out, but that's all in front of us.

Question – Andrew Kaplowitz: Okay. Could I ask you like approximately how big the education vertical is for you guys now? Because, again, I think it's a little bit under-recognized how much money is out there.

Answer – Dave S. Regnery: Yeah, I get asked a question a lot. I don't answer it. But let me do my best here. Look, as I think about our commercial HVAC business in the – in North America, right? 50% of the business is service, 50% is equipment. If you think about the equipment, think about it, 50% institutional, 50% commercial. And there's probably just like 14 different verticals that fit under those two broad categories. And we have strengthened all of those verticals. So that's one of the strengths that we have as a company is we're not over-dependent on any particular vertical. And we have expertise that exists in all of those verticals.

So, education, we've had a lot of success. Okay. I think I called it out in our fourth quarter call. I mean, our order – equipment order rates were up 40%, 4-0, in 2022. And a lot of that has to do with the approach that we take with our customers and the relationships that we have. If you remember, if you go back three years ago, and I never really want to go back three years ago, but in the beginning of COVID, right, we were talking about indoor air quality audits, right? And we're still doing audits today, but we were helping many of our customers in the education vertical think through how they make their schools safe today and what it would look like long term. The long term was kind of a roadmap as to what capital improvements you would need to make over time.

Well, then comes ESSER funding. I don't get it wrong. Elementary, Secondary School Emergency Relief Act. And the funding became available. We pulled those roadmaps out and basically went back to the customer and said, let us help you get funding because you already know what you have to do. These were shovel ready projects for many of the schools, and that's one of the ways that we took something a policy, ESSER funding, which on the surface is somewhat complex, made it simple for our end customers and helped them through the journey. And you could see the success we're having.

Question – Andrew Kaplowitz: So, speaking of complex, you talked about the IRA, right, I think implicit in sort of and maybe Chris said it on the call, like, in the second half of the year, IRA might start to ramp up for you guys as sort of states begin to set their own rules. So, maybe what, if anything, is in your guide for IRA and what kind of visibility do we have to the states actually getting their act together so that money can start to come out?

Answer – Dave S. Regnery: Well, I mean, I think the question – the way IRA is going to work is you're going to have federal funds that will go down to the states and the states have a framework that they're going to be operating within to qualify for this funding. But that framework will be a little bit different probably by each state, okay? We don't know that, but that would be a good assumption to make.

We're still actually helping clarify a lot of this, okay? We're a company that has such a broad portfolio of products that will be able to serve whatever the end solution is. We just want to make sure the end solution is optimal. So, originally this came out – and I think you may know this, Andy, but we only want certain high, very high sear product to qualify.

Well, okay, we can do that, right? But really, if you want it to be for a more lower income, well, that may not make sense, right? Maybe you want to lower that CRE requirement. And at the end of the day, heat pump is still going to have a dramatic impact on the decarbonization of the home. So, we're helping people clarify that and then we're hopeful that towards the back half of the year and it may go into the fourth quarter. We're going to start to see some of that funding be released. It'll be state-by-state.

As far as do we have it in our guide, we don't know what the impact is going to be there. So, we haven't – we have baked this in because we're not really sure what the impact would be. It would impact both residential and commercial, okay? So, you could – are we optimistic on our guide? We think we could – we have it a 6% to 8% for the enterprise. And we're very confident with that number.

Question – Andrew Kaplowitz: So, Dave, maybe you can help us with the state of the North American residential market. Like, I know it's not a huge portion of your business, but like – I feel like when you guys and your peers, it's kind of – I don't know, all over the place is maybe too strong, but – so, what you said to us is you think were you guys market would be down mid-single digits in unit terms, in 2023 pricing share gains were you guys will lead to relatively flattish revenue, that's kind of what you guide too. But can you give any color into your visibility? I think you mentioned higher than usual backlog, you still have that. But you mentioned that your distributors, your independent wholesale distributors on a relatively good inventory position and I feel like maybe one or two of your peers have said something different than that. So like any update?

Answer – Dave S. Regnery: Yeah. I mean, first of all, residential is about 20% of the enterprise so.

Question – Andrew Kaplowitz: After commercial, Dave, I asked it.

Answer – Dave S. Regnery: I know you did. So just to size it, okay? And if you think about our residential business, about half of that or 10% of the enterprises we go through independent wholesale distributors. So we're talking about what's the inventory level we're looking at that 10%, okay, or about half of the residential business. The fourth quarter and really part of the third quarter, we were very − we're always in touch with our channel partners, but we're very intense in helping them with the phase in and phase out of their inventory.

And as the regulatory change happened, depending on where you were located, we wanted to ensure that no one got stuck with stranded inventory and in the south its install date. So if you have it in your inventory, you won't be able to sell it after a particular date. We did not want anyone to be stuck with inventory that they would be calling others to figure out what they're going to do with, right? And that's a bad trail that would be down.

So we spent a lot of time helping them with what we call phase in and phase out. We do it all the time with our new product introductions. Some of our channel partners needed more help than others, but that was okay and we think their inventory is in a good position right now because of that. It wasn't about us shipping additional product to them in the fourth quarter. It was more about how do we make sure that they have the right mix and the right inventory that can set them up for success in the future. So that was the emphasis.

As far as what their inventory level, we think it's in a good position, right? We're – we do a lot of work there on making sure that we don't want our channel partners to be set up for a not – an unsuccessful year. So we spent a lot of time helping them with their inventory needs.

Question – Andrew Kaplowitz: And you have reasonably good visibility into replacement markets obviously. We'll see what happens here.

Answer – Christopher J. Kuehn: Yeah. We'll see what happens. I mean, at the end of the day, we all know what's happening with interest rates, right? We'll see what I guess the Fed's going to be releasing some news here, if they haven't already but soon we'll get that commentary. As interest rates go up, obviously, new home sales will go down and existing home sales will go down. So that shouldn't be a secret or anything. So it is going to tighten. Our guide is that we believe that the unit volume will be down in that mid-single digit range and we feel as though we'll be flattish, plus or minus 1%, 2%. That's kind of what we baked into our guide for residential. And again, it's 20% of our business. So if we were – if it was, went down an additional 10%, it'd be a 2% impact to the enterprise.

Question – Andrew Kaplowitz: So let me ask you about China. So you highlighted strong China demand in Q4. But can you talk about what you're seeing as the country moves past zero COVID and stuff and how you're thinking about the sustainability of growth in 2023? I know a few years ago you changed your strategy there. You went direct. So how is that helping?

Answer – Dave S. Regnery: Yeah. China is one of those areas where – first of all, our team in Asia had a great 2022, all right? The revenue growth was up 12%. Organic revenue growth was up 12%. And if you think about the challenges that we're faced in Asia, specifically in China, right, that's about half of our business is China for Asia. And I mean, just unbelievable obstacles that they face that they were able to overcome to achieve 12% organic growth.

As far as – as the economy opens up, we're cautiously optimistic as to what that's going to bring. I was on the phone last night, I guess it was two nights ago with the China team, and it's – they're very optimistic as a team. They have a lot of innovation that they're working on. And I think you're going to see that where we're strong in China has consistently been strong for a period of time. So think of data centers, think of these projects that take longer times to close or to influence.

Like a longer-term infrastructure project, you tend to have to go to the engineers, the architects become basis of design, really do a more of a selling effort or making sure you sell to all the different owners of the decision. And if you're going to just a distribution model, that's very, very difficult. That's why we made the pivot probably seven years ago to say, look, we're going to just go and develop our direct sales force in China specific. And we have. That's now seven years. We have a very mature sales force there and they're able to have that longer appetite to close orders. And that's why we've been so successful there for many years now with these longer-term projects to close.

As far as reopening goes, I think you're going to see it more in the hospitality section immediately, right? I mean, restaurants are open in China now. People are starting to go People are starting to go back to restaurants, malls, and they're starting to go back. But remember how long it took us here in the states to kind of stop wearing our masks when we went to the grocery store. Maybe some of us still do, which is okay. But it took some time and they've been really reopened now for really only less than three months. So they're still in the beginning of that process. So it will take some time, but it's – we're optimistic but cautiously optimistic in China.

Question – Andrew Kaplowitz: If I go back, Dave, like five, six, seven years ago, you're pretty small in Europe, like pretty small. You've grown in pretty quickly. And I know you talk about thermal management systems, so let's talk about that. But what changed in Europe for you guys, like, was it really just the innovation on thermal management systems side? Was it that it's become a little more of a cooling market? And where is your European business five years from now because it's come a long way, in fact?

Answer – Dave S. Regnery: I've been part of the long-term journey in Europe. So I was there when it was maybe not so relevant. I'll tell you what. That team – the innovation that they've been able to drive and how they look at problems and turn them into opportunities is the best I've seen in our company, and I've been saying that for years. So we're going to continue to drive that business. And the leadership team there is just – we're waiting today and we're going to continue to win tomorrow. And I know people always think of the HVAC and I'll talk just the commercial side of HVAC in Europe, right? At the end of the day, they're not that dissimilar in size versus North America. They're not that – they're smaller, but not that dissimilar. So there's a tremendous opportunity as more players there. Our innovation there is leading. It's hard to replicate because of the investment that we're putting there. And we're going to continue to win. And I'm very confident in that statement.

Question – Andrew Kaplowitz: Can I just ask you, thermal management system capability, it seems like a great fit for Europe. What can you do with it in the US?

Answer – Dave S. Regnery: I think it's a global fit, okay? I think it's about being able to understand the technology that exists today. So, you no longer need fossil fuel to heat buildings. It's a global fit. And we need to look at it as a global fit. So, we have solutions here in the Americas, a little bit behind where Europe is as far as the adoption of those solutions. But this is something that we all need to realize that you do not need fossil fuel to heat a building or a home. And the sooner everyone recognizes that, the greater the impact is going to be on the carbon footprint that exists for the built environment. This is a global opportunity, a global opportunity.

Question – Andrew Kaplowitz: So, we tend to have conversations with some of your competitors, where they talk a lot about sort of their service capability, beefed up by digital over the last few years, right? And sort of the promotions that they have. So, like – but you guys, your service has been the backbone of your company, little greater than 30% of business, high-single-digit growth rate. So – and maybe compare and contrast Trane right now and like sort of pitch that, hey, I can sell a whole healthy building. Like, why do you do well when you're an A-threat provider against these, hey, I can sell you a whole healthy building as I sit here in 2023.

Answer – Dave S. Regnery: Yeah. I mean, at the end of the day, you're right, service is about a third of the enterprise. It's been growing at a, I think, a compound annual growth rate as high-single digits for the last six years. Last year, it grew 10%, it was double digits. We continue to invest in this business, that's why it keeps performing well And I don't – I'm not trying to create a roadmap, so everyone can follow what we do. I would just tell you we invest heavily. We were talking about being connected to buildings and assets years ago, right? And a time people were like, oh, is that to improve the productivity of their service business? No, it was actually to improve the energy efficiency of the asset that was being used.

Being broke in the service in the HVAC world is no longer the product doesn't work. It's broke now when it uses too much energy. We were out there talking about digital twins. I used to have to explain to people what was a digital twin and why it was important. So we're going to continue to invest in the business. I won't get too specific as to how we would do it. I would just tell you, we have a very detailed way of operating our service business. We love being connected to the assets. We love the opportunity that it presents. We have a very strong building management control system. We operate many buildings around the world because of that. So this is a growth opportunity today and it will be well into the future.

Question – Andrew Kaplowitz: Dave, just one thought there. Everybody sort of asks your peers around attachment rates and we don't seem to ask you guys because you're basically 100% attachment.

Answer – Dave S. Regnery: Because I don't know what they mean by attachment 00:28:54

Question – Andrew Kaplowitz: Like, if I remember correctly, like China was a little lower attachment for you guys, but you were sort of working on that. Like, how do you want us to think about attachment?

Answer – Dave S. Regnery: When I − when you − when we sell an applied system, right? We always want to be connected to that system, so we could ensure that it's operating the way it was designed. And most of these − all of these systems are under warranty for some period of time. So, of course, we're going to be attached to it. We want to make sure that it's performing the way it was designed. And unfortunately, these are mechanical products that sometimes things happen that have to be adjusted. We want to make sure we're there and the customer is very pleased with the solution that they purchase. So we're 100% attached to our applied systems out of the box. Of course, we would have to be. As far as our competitors, I'm not going to comment on specific competitors, but when you talk about attachment rates, again, these are terms that get loosely thrown around. And I'm not sure what they mean or how they're tracking it. And I personally stayed away from talking about what that would be because it's just going to confuse many of you and other customers to be quite fair about it. But at the end of the day, we have high-single digit growth in our service business on a compound annual growth rate across the world, okay, and that's over six years now. So our performance kind of speaks for what I'm preaching about up here.

Answer – Christopher J. Kuehn: Andy, your earlier question of backlog, though, just to be clear, our backlog does not include service. So the $6.9 billion, while we may have one, two, three years' service agreements, that's not in the backlog calculation. We book it and we revenue it in the period in which it's earned. So just that could be a little bit of a difference in how peers may include or not include that in the backlog.

Question – Andrew Kaplowitz: Yeah, that's helpful. I want to open up to the audience in a second, but let me ask you about TK, about Thermo King. You've – the last couple of years, I think you take a nice share, both in the Americas and EMEA. So maybe talk about the key drivers of that sort of market outperformance. And then I do have to ask. I think your main peer mentioned it see – it saw container-related near-term weakness which I don't – you didn't cite as a big concern. So is that because it's relatively small portions TK or how concerned are you around potential cyclicality in TK over the next couple of years?

Answer – Dave S. Regnery: That's a long question. First of all, our Thermo King business has performed very well on a global basis for the last several years.

And I would say that we lead there, where I can lead with the rest of our company around innovation, right? If you have a product that's 30% more efficient than anything else on the market, it's not very – I was – I tell the sales team, they disagree with me. It's not very hard to sell, right? If I could go show you, let's go side-by-side, put two units there, see which one runs out of fuel first, right? Pretty simple test.

So, I mean, these products are – people want them, right? If you could save 30% of your diesel consumption, you're going to go with that solution. They're more expensive, but the payback is obviously very accretive for the bottom line of these trucking fleets. We're a very diversified portfolio in Thermo King. It's not like it was 10 years ago we're so reliant on just trailers now, truck trailer, eight auxiliary power units, air, marine, rail. These are all part of the portfolio of our Thermal King products.

Question – Andrew Kaplowitz: Containers. Any...

Answer – Dave S. Regnery: Containers is – it is a smaller portion of our business, but we've actually had some pretty neat innovations there as well. And we invest in our portfolio. We have it in our portfolio, we're going to invest in it regardless of what the size of it is because we always look for where the opportunities are.

Question – Andrew Kaplowitz: Questions from the audience. Any questions? Anybody want to ask a question? All right. I will continue. So, free cash flow, you usually have done a great job with free cash flow. A little bit of pressure in 2022. And we know that was probably related to strong Q4 shipments and timing of collection and receivables. So, if you can talk about visibility in terms of getting at or above 100%, which I think is your guidance for 2023?

Answer – Christopher J. Kuehn: : Andy, I was certainly going into the earnings call, very little nervous with 91%. But as I step back and I see how others have reported.

I feel really good that we had a very strong year in terms of free cash flow for the company. The three-year average of free cash flow is 110% conversion to net income. So it's just part of the business operating system for us to always, A, the business generates a lot of cash, and B, how do we manage working capital?

To your point, in the fourth quarter, we saw just revenues come in a little later in the quarter in terms of growth in commercial and Thermo King businesses and then some specific inventory investment around $40 million to drive resiliency and supply chain resiliency. Those are the right investments to make. What it means is we'll probably start the first quarter a little bit stronger in free cash flow just given natural timing, but I'm confident we've got a plan to go after 100% or greater free cash flow this year. That's how we'd look at every year in terms of a target just given the powerful cash flow the business drives, which gives us a lot of optionality what do we do with that cash, which is the fun part of the job where we decided to play, but we'll have some modest working capital investment. We're great standard work around receivables, payables, inventory, and where do we want to be invested and have some resilience that that's a good investment to make.

Answer – Dave S. Regnery: Yeah. I mean, some of the investments that we made in inventory and we have made some investments in inventory, really paid dividends. I mean, look at – I'll go back to China. We were talking about China before. There was really rolling blackouts in China for an extended period of time where people were basically locked in their homes. So we wanted to make sure that if one of our suppliers went down, regardless of where they were, we would have enough safety stock so we could run our factory and you see the results that we've been able to demonstrate there.

So that's an example of I know people often talk about where we're making an investment in inventory. You're adding basically safety stock. Here's where we added the safety stock and what you could look back on and say, they're brilliant, right? But you could say that if you want. But, at the end of the day, it really was the right investment to make. And as Chris said, we put more inventory in place in the fourth quarter because I was very nervous about the reopening of China and could that have an impact on the suppliers that are providing – especially on the Tier 2 suppliers that are in China. And I didn't want to go back to any kind of a rolling, shutdown or lockdowns in China. So that's why we did that.

Question – Andrew Kaplowitz: And David, because you guys have been pretty clear about how you're going to spend the cash, right? You've given us a good roadmap. But maybe talk about sort of your key priorities on the M&A side and just in the sense that you've been relatively quiet in M&A, I guess is all I'll say. Could you do a better deal? You just look at smaller bolt-ons? Like, what do you think about M&A in 2023?

Answer – Dave S. Regnery: I would say we're disciplined in our M&A. Okay. We don't have to do anything with the portfolio that we have. We have great products. We have great service. We have great controls. We have a great service business. We have a great footprint. That said, we're always looking at technologies. We're always looking at where we could bolster our portfolio and these smaller tuck-ins, okay, we leverage quite – we scale quite quickly.

I mean, we acquired AL-KO Technologies – Air Technologies in Europe. It's really going to add nicely to our portfolio there. We'll scale that business quite nicely. And it's relatively small, again, like less than 1% revenue for the enterprise, but it's the technology we like. And with our channel on the strength of our channel, these bolt-ons become scalable very fast.

Question – Andrew Kaplowitz: And I just want to ask you, you mentioned increased investments in 2023, things like advanced manufacturing and automation, digital and electrification, any more color on sort of the returns on these investments, why you're ramping up now or is it just – it's going to be related to my next question about megatrends, which...

Answer – Christopher J. Kuehn: Do you want me to start?

Answer – Andrew Kaplowitz: Go ahead.

Answer – Christopher J. Kuehn: Look, we've got a great pipeline of investments. And we said we may not necessarily be in any one year the best organic leverage company because we want to make sure we're funding those investments. We know that creates the flywheel that we've been able to drive above market growth for many years now. So we're – just having higher investments around factory the future and automation. Looking at our existing four walls and how do you get more capacity out of that, redirecting maybe some of the workforce out of tasks of moving equipment and materials to ultimately driving more output. So that's a great investment to make.

Investments on the digital space, think of that as not only supporting the connected buildings growth each and every year, but our front line sales technicians, our service technicians, they're out there working with the customers. Just make it easier for them to engage and find solutions. So we're making investments there as well, Andy. Electrification of the portfolio, right, you mentioned Thermo King and we like getting those slides so far into the earnings deck around our performance of Thermo King. And that's – the outcome in 2021 and 2022 and the growth versus the market is because of many years prior building those innovations and those investments. So that's the flywheel we keep driving.

After that, we are doing some resiliency moves within the company. So think about footprint moves that will drive more resiliency to have places of more concern around weather events and concerns we'd have some resiliency there to go ultimately have an offset if something were to occur. But we like those investments. They drive great outgrowth and will contribute to our 6% to 8% growth in the year.

Question – Andrew Kaplowitz: Got it. And then one more...

Answer – Dave S. Regnery: you won't get your last question.

Question – Andrew Kaplowitz: Yeah. Thank you. So just we're asking all the companies is what are the top two or three innovations megatrends or structural changes affecting your company over the next five years? And are there any emerging industry trends that are perhaps being overlooked in the current fiscal?

Answer – Dave S. Regnery: Well, I would tell you that the megatrends around decarbonization and sustainability are only going to intensify, right? The planet continues to get warmer, right? There was a study released that said the last seven years were the warmest on history as long as records been kept on the planet, the warmest seven years. And the harsh reality of it is, they could be the coldest seven years for the rest of our lives unless we do something about it.

So it's – we need to take action and we need to take action now. So as an overarching megatrend, that has to be a focus for everyone around the world. And I think you're going to see electrification of the portfolio, elimination of fossil fuel for heating. Those are all ways to achieve the goal that we all need to be able to get to, which is to lower the rate of global warming and stop it.

So we have a lot of work to do around the world. And I would tell you as a leader in HVAC, we're doing our best to influence our entire industry because we know our industry can have an impact on the world. So...

But hey, thanks for coming today. Thanks for being interested in Trane Technologies and hopefully look forward to talking to many of you on the one-on-ones.

Thanks, Dave and Chris. Appreciate it.

Thanks, Andy.