Trane Technologies
Barclays Industrial Select Conference
February 19, 2025 / 9:50 a.m. EST

Julian Mitchell: Well, thanks very much, everyone, for being here. It's my pleasure to have up next Trane Technologies. Dave Regnery, Chairman and CEO; Chris Kuehn, CFO. Thanks very much, both of you for being here.

Maybe to start off, I guess it's a question that is exercising the minds of a lot of investors right now around backlog. It's a very high number, has been a very high number for a couple of years. How are you thinking about the backlog progression from here? How confident are you that Trane can still generate revenue growth at times plus GDP?

Dave Regnery: Sure. If you don't mind, let me just start at a different level, and then I'll get to answering your backlog question. But look, 2024 was a standout year for Trane Technologies. We had top line growth of 12%. We had EPS growth of 24%. We had free cash flow conversion of 109%. We had order growth of 11%. We had a book-to-bill of 102. So, we had a very strong year in 2024.

And I know there's a lot of buzz right now around data centers, and yes, data centers are an important vertical for us. And we've been strong in data centers for a long time and will be strong in data centers well into the future. But I want everyone to know that Trane Technologies is much more than just data centers. In fact, in our commercial HVAC business, we had growth in 13 of the 14 verticals that we track. So, we had not only nice growth, but we had broad base growth. We also had our service business that was up in the low teens again in 2024. So, we have a great business. We have a great portfolio of products, and we had a standout year in 2024.

Now on to Julian's question about backlog - look, our backlog is very strong. It's $6.75 billion. It's basically flat year-over-year, and that's despite having headwinds of around $0.5 billion during the year. We had some adjustments where we took orders out of our backlog in China. We had FX that worked against us all year. And then we had a normalization that occurred in our shorter-cycle businesses like Thermo King. So, we had adjustments of $0.5 million, and our backlog is still flat year-over-year.

And if you go a little bit deeper in there, you'd say, "Wait a second, you had 12% growth. Your backlog is still at a very high level. And if you're a historian of our company, you'd say, "Hey, look, when you start the year, you typically have about, 18% to 20% of your backlog for the revenue in that year. Well, if you do the math on that, that would say we'd be well over $30 billion this year. And I'm not committing to the $30 billion number, but we are very comfortable with our guide of 7% to 8%.

So look, our backlog is in a very strong position. And our commercial HVAC backlog in particular, is very, very strong. In the fourth quarter, we had order growth in the Americas of high single digits, two-year stack, well north of 20, three-year stack, north of 30. So, this is very strong growth and very consistent growth. So, we're able to deliver nice top line growth and maintained a very, very solid backlog. And I can tell the same story about EMEA, very strong as well, and it continues to have a lot of strength. So our backlog, I'll just remind everyone, and I'll let you get on to your next question, is we don't include services in our backlog. And services is 1/3 of our company. It's not in the backlog number -- and we've been able to demonstrate consistent growth in services over a long period of time of the high, high single-digit range. So we're comfortable with our backlog. We're also comfortable that what we see in our pipelines okay? So these would be the activity that we have with customers before we even get an order is extremely strong, extremely strong right now. And that would be on a -- really on a global basis, but specifically in the Americas, where we have very sophisticated CRM systems.

Julian Mitchell: Thanks very much, Dave, and when you think about sort of incoming orders, there's been some noise obviously on the data center vertical this year, but when you think about sort of incoming orders on the equipment with that noise in data center with interest rates that are still high, how confident are you about kind of orders growth and order rates looking like?

Dave Regnery: Yes. I mean, I'm not going to forecast a backlog number or an order growth number. But I will tell you that I expect our backlog to be at a very high level for the foreseeable future. I think you asked me the same question last year, and I gave you the same answer, and here we are a year later, and our backlog is the same number. We are very confident in our guide for the year. Our backlog gives us a lot of visibility into 2025, and our pipeline activity gives me even more confidence in our guide.

Chris Kuehn: Yes. Julian, I'd add interest rates haven't necessarily been a big impact on how we think about orders coming in. The paybacks on our systems are very strong in the commercial HVAC space, not uncommon to see four years or three years or less paybacks in the Thermo King space. We're talking two to three year paybacks here on fuel savings or energy savings. So interest rates really haven't played into that slowdown, let's say, in terms of orders. The paybacks are just so strong.

Julian Mitchell: Perfect. And you mentioned on the commercial HVAC side, verticals, 14 of them, you had orders up in almost all of them except one last year. When you're looking at kind of this year ahead, are there any of those 14 that you think things may move around much? I think education people ask about but life sciences is the one that wasn't up last year.

Dave Regnery: Let’s start, data centers is going to be strong. You probably are reading the same reports I'm reading. That prediction is 15% to 20% growth really for the next 4 or 5 years, too, in that space. So that will be strong.

Education, we believe, will be okay. I know ESSER funding is over. We have a lot of orders in our backlog that we need to fulfill. But I would also tell you that 1 of the things that ESSER has done is it's pointed out how underbuilt the infrastructure is for K-12 schools. And there's a lot of different funding mechanisms for K-12 that are being utilized like municipal bonds, for example, or our ESCO business, for another example. So we believe that will continue to have strength. It's a very large vertical for us, and we're very strong there. K-12 will be very strong. And the fundamentals are, if you think about our solutions, right, we have I would argue the broadest portfolio in the industry, the most innovative portfolio in the industry. And if you think about the macro trends around decarbonization, they're not going away. And if you think about our solutions, what Chris articulated earlier is our solutions have great paybacks okay? And they have a great impact to decarbonize the built environment. And whether you believe in global warming or not, and I hope everyone does, because there's a lot of science there, right? The payback is also very important. And it's what we call “green for green.” And when you take that and you say to someone, I could reduce your carbon footprint by X and by the way, the payback on this investment is, make up a number here, less than 2.5 years, it's a very compelling story for our customers across all verticals. And again, our portfolio designed around all verticals, a direct sales force that has deep domain expertise and knowledge in the particular verticals and technical aptitude within the verticals. It's a great combination, and it really allows us to win across all verticals. And by the way, then you have a service business that's 1/3 of the company that's wrapped around all of that. So it's a great place to be. I mean, this is a great proposition, right? If you have something that's good for the environment and has a great payback on your income statement, why would you not do the project.

Julian Mitchell: That's good context. And within sort of data center, specifically, people can go down all sorts of rabbit holes. But I guess one question that often comes up is around liquid cooling technology, what are Trane's aspirations in there? How does it see liquid cooling complement or substitute for the traditional space cooling business that you're very strong at?

Dave Regnery: Yes. I mean let's take a step back and talk about data centers, right? I need to be very simplistic here, and I'm going to use all the wrong terms. So, if you're a hyperscaler, you're in data centers, you'll say, what is he talking about? Think about a data center, right, three or four elements of cooling, are really three. You got to remove the heat, right? So that is the condensing side of the equation. We'll call that a chiller, right? That's required. Then you have to remove the heat from the data hall, right? That's what we call the air handling side. We're very strong there. We're very strong in the chillers. Then you have what we would call the terminal side, right? And that's where you're really doing direct cooling to chip or other mechanisms like immersion cooling as well as another one that's not quite ready for prime time, but it could be. There, we have great partners. All of all these systems, you have to remove the heat from the data center, okay? So they all are required right now, the condensing side or the chiller to basically remove the heat.

So look, we're very strong in data centers. We'll be very strong in the future, and there's a lot going on. And I know there's a lot of, "well, is this a learning data center," which requires more power or as an inference data center, which requires less power. A simple way to think of it is, what's the size of the data center? Is it a one gig data center? We're going to provide you 1 gig of cooling capacity, right? Because at the end of the day, what do data centers produce, bits, bytes and heat, right? So, bits, bytes and heat. We have to remove the heat.

Now another question we should be asking ourselves is, what are we going to do with the heat that's being removed from the data centers? And I think that's a massive opportunity for the future. And that's where you have to be thinking creatively as to how you can repurpose that, or is it just you put it out into the atmosphere and waste it? Or is there another solution? And there's a lot of work that's going on there that's not ready yet for this audience, so we're not ready to start talking about that publicly, but there's a lot of work going on there. Is there a different solution to make that data centers even more efficient by the wasted heat that's being produced.

Julian Mitchell: And when you think about the services business, how should we think about the penetration or the attachment of your services business, maybe depending on those verticals or different-

Dave Regnery: Again, a simple rule of thumb. The more sophisticated the product is, the greater aptitude for an OEM to do the service work. Our service business is designed around our applied systems. Data centers use very complex applied systems. So, there's a nice service tail there well into the future.

Chris Kuehn: And service is still about 1/3 of the company revenues, Julian. And it should be larger with the exception of how strong our equipment growth has been. And since services is applied -- is linked to applied systems, rough math here, look at our Americas commercial business, our EMEA commercial business, in the last 3 years, the applied equipment revenues have doubled in each of those businesses. So that's the strength of the equipment markets. It brings the service tail and that service tail really start in those first two or three years post installation, right? There's warranty periods, and we get through that warranty period and then the newer product probably needs a little bit less service, but you start growing that over time, the service dollars really bring that eight to ten times the value of services versus the original equipment. That really starts kicking in a few years after installation.

Julian Mitchell: And when you look at, say light commercial and people have different definitions of that market, but for what you're doing like commercial, there's no data center there. Maybe it's a little bit more interest rate sensitive, how do you assess the health of that market?

Dave Regnery: Look, we have a broad portfolio of products and what we sell to customers is solutions, right? We don't care if it's light unitary, or it's applied. I'll start with that. So we're not forecasting a light unitary market. There are verticals that tend to use one versus another. At the end of the day, look, we're going to have growth in both in 2025, Applied will be stronger than Unitary. And that's just based on our backlog right now. We see what's in the backlog. So we'll continue to utilize the entire portfolio and will help the customer make the right decision as to what's the right product to satisfy their needs.

Julian Mitchell: Great. And when you look at the Applied side, it seems like lead times have been long for a while that may be helped with pricing and so forth because of tight supply. You and your peers have been adding some capacity but demand growth is still strong. So sort of from the outside, how should we think about how are lead times trending? How much of your orders being booked today for delivery in 2026, for example, in Applied?

Dave Regnery: Well, first of all, lead times have basically retracted quite significantly from maybe where they were at a peak in 2023, right? We had lead times that were very extended at that time period. Now they are at a more normal level.

On the capacity side, look, we've certainly added capacity and four wall capacity within our Applied portfolio. We've also added some of the Unitary portfolio as well. So look, we're able to meet the demand.

The question is, you have a lot of data centers that are talking about what they're planning out for '26 and '27. You should understand that the long pole in the tent is not HVAC, right? They're planning out for different reasons and HVAC is not one of them. If a data center customer came to us today and said, "Hey, I still need applied systems in 2025," we'd be able to fulfill that order. I don't want anyone to think that we're the reason why data centers are planning out. Data center customers and other customers, too, if you think about mega projects, they are providing longer lead times than they would have maybe, say, five or six years ago, and they really just want to make sure that they can reserve slots to make sure that we're able to meet their expectations.

Julian Mitchell: Got it. And the bottleneck to your point, it's more around the power side?

Dave Regnery: Yes. I mean if you ask a data center customer, what's your biggest concerns, right? They might tell you land and power. It's really probably power and land. But if they have the power, they're going to find the land, and we're going to be there to help provide the cooling for their applications.

Julian Mitchell: Got it. And competition-wise, some parts of the market, just because of the expected growth, let's say, liquid cooling, it feels that there's a lot of people who have been sort of pulled into it, adding capacity, making CDUs and so forth. How do you assess kind of competition, the discipline of it, the level of it across the whole commercial HVAC business?

Dave Regnery: There are certainly a lot of companies that want to talk about how they’re now into data centers, too. I remember when I was growing up a long time, during the dot-com era, and everyone would say, “we're a dot-com as well.” I feel a little bit of that right now, which is “we do data centers, too,” right? So look, there's certainly a lot of companies that are out there making cooling distribution units, CDUs, cold plates that's all on the terminal side. Remember, they all require this condenser over here to remove the heat. That's the chiller, which we're very strong in.

There's a lot of demand out there right now. And I think that demand will continue in the future. So there's a lot of companies that are trying to adopt to make sure that they get their part of that. I would tell you that we've been very strong in data centers for a very long time, and we'll be very strong in data centers well into the future, but we're more than just data centers. right? We play in all verticals and that broad-based growth that I talk about is very, very important. I was at the AHRI show was down in Orlando this year, and I don't normally go to it, but I had to meet with someone, so I decided to walk in for three or four hours and walk around, and I went up to someone. And you have a badge on, right? And it says Dave Regnery, CEO/Chair. And I was like, "Oh, gosh, here, I am trying to hide my badge. But I wasn't trying to be deceitful or anything. But, I went into one competitor's booth, a smaller competitor, but I was like to “tell me about your company” and of course, this individual is going to tell me everything I want to know about the company, so I almost started backing off. But at one point, they said, look, we're only going to focus on data centers. And I'm thinking to myself, "Wow, that may work today. What's going to happens in four or five years? I mean you want to be broad-based. I mean that's a strategy that I would look at and say that could be flawed, right?

There could be disruptions. The data center's technology moves really, really fast, right? You've got to be really, really quick. You want to be able to invest like Trane Technologies to keep up with some of that technology. And here's a smaller company that says, we're only going to focus on data centers, and I'm like, okay, good, good to know, but thank you. So, we're broad based. We're more than just data centers. If you take away nothing else, we're more than just data centers. We're strong in data centers, but we're more than just data centers.

Julian Mitchell: One thing on that point around sort of breadth and the lead time discussion, how do you think about price right now? I think you guided for a point of price or so last this year, and that's an enterprise-wide number. So I understand there's resi in there and TK. Kind of how do you think about price across the business?

Chris Kuehn: Sure. Yes, I'll start. We guided to about 1.5 point of price for 2025. We closed out 2024 around 2.5 points of price. And you think about our 12% revenue growth, it means we had 9.5 points of volume growth. So for our guide of starting out the year for 2025, of 7% to 8% organic, it's meaning we're in six-ish range for volume and about a point, a little over that, for price.

Think of that as announced price increases at the tail end of 2024, very early part of 2025, really ex tariff, okay? It's looking at the state of our Tier 1, Tier 2 components, net-net, modestly inflationary and targeting another year 20 or 30 basis points above the cost level to ultimately get a positive price/cost spread.

Maybe the next ancillary question will be around tariffs, right, ex-tariffs, that's our price. But we're running the scenario playbooks today. We know from this administration's 1.0 level and then going through supply chain challenges, having to stay ahead of cost and pricing effectively. We built a strong operating system around that, we've got our playbooks in place. What I would say is we're even more in region for region. It's been our strategy for decades were even more in region for region today than we were even 7, 8 years ago. Think of the Americas as we have one component factory in Mexico, and we have over 20 factories in the U.S. We have factories in Europe. We have factories in Asia. We have factories in China and outside of China. So the thoughts around moving big product around the world, that really is less and less and it's been less and less over the last 10 years. But certainly, we'd be looking at the supply chain, the Tier 2, Tier 3 that could be impacted from a tariff and we'll respond accordingly. We're ready to go to put a price increase as need to defend the margin. And we'll see what the news is and what ultimately transpires. It's important for us to hear what's coming out, but then not be overreactive. Let's see what the actual truth is.

Julian Mitchell: Great. And you mentioned, Chris, the sort of guidance for this year and so on. I think the first quarter guidance surprised people when you issued it ad it was stronger, I think, than many expected partly people worried about the pre-buy hangover in residential. So maybe sort of help us understand the sort of thinking behind that first quarter guidance, how comfortable do you feel about the resi market in general?

Chris Kuehn: Sure. I mean we guided the first quarter 6% to 7% revenue growth, again, full year 7% to 8%. So maybe a little bit lower than the full year. A reminder, the first quarter for an HVAC company isn't exactly the biggest quarter of the year. But you're right, we're starting out the year and our guidance was for our commercial HVAC businesses. in the Americas and EMEA would be up high single digits in the first quarter. Transport markets in the Americas, it really appears to be the bottoming out of that cycle. Market is down over 25% in the first quarter. We should outperform that, but we expect that business to be down. Second half, we'll see the growth, but first half will be down.

And then residential, we'll see where that falls out. It could be flat to slightly down in the first quarter. It could be. We had a modest prebuy. We thought all of 2024 that the prebuy would be modest, and that's really where it landed, $75 million to $100 million, is our best estimate, probably split 50% in the third quarter of last year, 50% in the fourth quarter of last year. But let's see how that prebuy ultimately gets overcome probably in the first half of the year. We'll see how much is Q1 versus Q2. But all in, confidence in the 6% to 7% guide as we released that a couple of weeks ago. And a lot of that is the backlog that we have, the backlog entering the year, when do our commercial HVAC customers want the equipment and delivering it to them on time and making sure that their projects keep moving forward.

Dave Regnery: Why don't you just give the math on the resi, how we got there with the GDP plus?

Chris Kuehn: Yes. So from a full year, we guided resi mid-single-digit growth. And think of it as three components. First would be the return to a GDP-plus business for the full year. A little bit of tailwind from IRA in there should be responsive to a GDP-plus business, which is what that business has been over the long term. 49 of 50 states have approved the IRA funding, I think 12 states or more now. have the funding at the state level. Actually, just a couple of weeks ago, the governor in North Carolina visited our campus in Davidson, North Carolina and rolled out their IRA benefits at that time. So that's one piece of the growth. Second piece is, as we think about that refrigerant transition for us, the 454B, we've said that's around a high price increase. We don't report that in price, Julian. We'll put that in volume. But think of that high single-digit price increase on 65% of the portfolio multiplied by 75% of the year, gets you around a mid-single-digit contribution to revenue.

And then the third piece would be deduct from that the impact of the pre-buy, probably around three points. So you add those up, you get to about a mid-single-digit growth factor for resi is what our guide is for the year.

Julian Mitchell: Perfect. And then on transport, it's been a tough market for a long time. You mentioned that it's down a lot.

Dave Regnery: We're in year four of a two-year cycle.

Julian Mitchell: What's needed to get that cycle running again?

Dave Regnery: Yeah, it got overbuilt during the COVID period. And I'm being flippant here a little bit with – "we're in year four of a two-year-cycle." But yeah, Transport has been down for a while. And right now, what we're seeing is the first half is going to be tough of 2025. We see the second half being stronger. We agree with that, that 2026 and 2027, we'll have nice growth.

So look, I had the opportunity to run this business once early in my career, right around the 2010 time period. So if you remember what happened in 2010, I'll remind you, it was the Financial Crisis. Well, my gosh, the world was ending, right? And nothing was going to happen. All the sudden, the Transport market started to come back. And when it started to come back, it came back very, very fast, to the point where I could remember putting on second shifts and third shifts within the same quarter to meet the demand. So look, this market is going to come back. I'm very confident in that. And when it comes back, it will come back fast. And the important thing is that make sure you continue to invest in your business even though the markets may be down. And we have done just that, as Trane Technologies. We'll be more than ready to serve our customers with really innovative products when this market comes back. But just to be a little bit patient. I've been patient for a while on this one. But it will come back. Think of it in the back half of this year, we'll start to see some upticks.

Julian Mitchell: Great. And then on margins, you have the 25%-plus organic operating leverage framework. Your own margins in the P&L have been moving up in recent years, which is obviously a good thing. But when you take that plus the service tail that you're building from all the equipment growth recently, it feels like there should be upwards pressure on that operating leverage medium term. Kind of any thoughts on that?

Chris Kuehn: Yes. No, it's a great question. And look, the last couple of years, our- our incrementals were in that 30% range. But when I think about how we start a year and how we plan for a year, we're looking at top quartile revenue growth, top quartile cash flow, and really strong cash flow. You know, cash doesn't get a lot of attention, but if you want to talk about high-quality earnings, let's talk about cash flow and we've been able to demonstrate that over time. We like that 25% plus model. You know, if I look over the last four years, and Dave said it kind of at the open, the 12% revenue CAGR, the four years consecutively over 20% EPS and then 108% average free cash flow, we think that, that model of making sure we're investing back in the business first, that has absolutely driven our outperformance over the last four years in that model, we would expect to continue to be that flywheel that will drive outperformance into the future.

So, the pipeline for investments remains very strong. A couple of times a year, in fact, late in December, we had our innovation reviews within the company and the pipeline of innovations that we have is very strong, and it's our job to make sure we keep pulling that and pulling that early as much as we can to get those products out into the marketplace that much faster. So we like starting with 25% or better, and then we'll see how the year plays out, but a lot of confidence in putting that guide out for the year.

Dave Regnery: Look, a simple rule as a CEO, and I try to tell individuals that are joining our company, especially someone right out of college. What makes us successful – stay close to the customer never stop innovating in your business - never stop innovating. Customer, innovation, and culture. Make sure your culture is very robust. And when you do that, you start operating, pay attention to the top line, pay attention to the bottom line and pay attention to the quality of the bottom line. Revenue growth, EPS growth, free cash flow conversion. And if you look at what we've been able to demonstrate over the last five years as Trane Technologies, I think you could argue- that we're a top decile of all industrials in those metrics and we're very proud of that, but we also see the brightest days are yet ahead of us because of all the mega trends that we see and the opportunities that we have in front of us.

Julian Mitchell: Perfect. Well, with that, we have to switch to audience response survey questions. So if we could bring up the first one.

Dave Regnery: I always like the survey here, live feedback.

Julian Mitchell: Next question is around sort of general bias right now towards Trane. So very positive. Third question is around through-cycle earnings growth of Trane versus the, call it, multi-industry group average.

Dave Regnery: Thank you for recognizing.

Julian Mitchell: Lot of conviction. Fourth question is around what should Trane do with excess cash? So organic reinvestment. Penultimate question is around the multiple, I think, what PE should Trane trade at?

Chris Kuehn: There is no option seven, Julian, or eight?

Julian Mitchell: So generally a premium to the S&P. Maybe I thought it was EV sales or something. And then the last question is around, yes, why it didn't like there was much ownership in the room. What's the biggest single reason for that on fundamentals? So, core growth which has been okay.

Dave Regnery: Okay. Well, thank you all very much for your interest in Trane Technologies and certainly enjoyed talking to everyone today. Have a great day. Thank you.

Chris Kuehn: Thanks, Julian.

Julian Mitchell: Thank you, Chris.