Q1 2020 Trane Technologies PLC Earnings Call

SWORDS May 5, 2020 (Thomson StreetEvents) -- Edited Transcript of Trane Technologies PLC earnings conference call or presentation Tuesday, May 5, 2020 at 2:00:00pm GMT

CORPORATE PARTICIPANTS

Christopher J. Kuehn, Trane Technologies plc - Senior VP & CFO

David S. Regnery, Trane Technologies plc - President & COO

Michael W. Lamach, Trane Technologies plc - Chairman & CEO

Zachary A. Nagle, Trane Technologies plc - VP of IR

CONFERENCE CALL PARTICIPANTS

Andrew Alec Kaplowitz, Citigroup Inc, Research Division - MD and U.S. Industrial Sector Head

Charles Stephen Tusa, JP Morgan Chase & Co, Research Division - MD

Jeffrey Todd Sprague, Vertical Research Partners, LLC - Founder & Managing Partner

John Fred Walsh, Crédit Suisse AG, Research Division - Director

Julian C.H. Mitchell, Barclays Bank PLC, Research Division - Research Analyst

Scott Reed Davis, Melius Research LLC - Founding Partner, Chairman, CEO & Research Analyst of Multi-Industry Research

PRESENTATION

Operator

Good morning ladies and gentlemen, thank you for standing by and welcome to the Trane Technologies 2020 Q1 earnings conference call. My name is Jason and I will be your operator for the call. The call will begin in a few moments with the speaker remarks and then a question and answer session. At this time all participants are in a listen only mode. To ask a question during the question and answer session you will need to press star one on your telephone. We will limit questions to one question and one follow up. I would now like to hand over the conference to your speaker today, Zac Nagle Vice President of Investor Relations.

Zachary A. Nagle, Trane Technologies plc - VP of IR

Thanks, operator. Good morning, and thank you for joining us for Trane Technologies' First Quarter 2020 Earnings Conference Call. This call is being webcast on our website at tranetechnologies.com, where you'll find the accompanying presentation. We are also recording and archiving this call on our website. Please go to Slide 2. Statements made in today's call that are not historical facts are considered forward-looking statements and are made pursuant to the safe harbor provisions of federal securities law. Please see our SEC filings for a description of some of the factors that may cause our actual results to differ materially from anticipated results. This presentation also includes non-GAAP measures, which are explained in the financial tables attached to our news release. Joining me on today's call are Mike Lamach, Chairman and CEO; Chris Kuehn, Senior Vice President and CFO; and Dave Regnery, President and COO. With that, please go to Slide 3, and I'll turn the call over to Mike. Mike?

Michael W. Lamach, Trane Technologies plc - Chairman & CEO

Thanks, Zac, and thanks, everyone, for joining us on the call today. Under normal circumstances, I'd start today's call with a brief overview of our global business strategy and how that's enabled us to deliver strong financial results to our shareholders. But today, we're living through anything but normal times. So suffice it for today's call, although we've got a new look and feel under our new Trane Technologies branding, our long-term strategy is unchanged. With that in mind, I'm going to move directly to Slide 4 and

into the heart of our presentation today. The focus of our call today is less about earnings in the quarter or even in 2020 and more about the long-term health, strength and positioning of Trane Technologies as a pure-play climate control company as business conditions adapt and eventually improve in a post-COVID-19 world. The depth and duration of a downturn and subsequent recovery is a multi-varied equation that's impossible to solve. None of us have ever experienced anything like this in our lifetimes. And we can't effectively draw conclusions from historical reference points because there aren't any. Social distancing has never been part of a recession vernacular. And it provides layers of complexity to our daily life that has far-reaching personal and professional impacts that we're learning about and trying to adapt to as we go. And for some, these impacts are more devastating and more personal than others.

As a global leader in our field, working with thousands of customers and suppliers and touching the lives of exponentially more people, how we lead through this crisis and the things we prioritize matter deeply. The implications of leading companies' actions are far-reaching. Major employer acting with a singular short-term profit focus can take down a community. A community can take down one or dozens of companies. And the unintended consequences can keep rolling downhill, exacerbating an already very challenging situation.

We strongly believe the right course of action for our employees, our customers and our shareholders is to lead authentically, steadily and with a sense of purpose. We will remain true to our strategy, maintaining world-class employee safety, acting with uncompromising ethics and integrity, supporting the communities in which we live and work and steadfast in our commitment to building a more sustainable world. These are the fundamental building blocks that drive sustainable, differentiated financial performance for our shareholders now and in the long term.

With this context in mind, our core operating principles through this downturn are clear. First, protecting the safety and security of our people is paramount. And here, I'll start by saying that we have retained more than 95% of our talented workforce annually for over a decade. And a strong and talented employee base is the most important factor in creating great customer experiences and shareholder returns. We have benchmark levels of employee engagement, which is core to our culture and values. And this is a differentiator that is often overlooked.

Each time we survey our employees the top 3 things that our people identify with our culture of engagement, our sustainability purpose and the belief that one company can change an industry and the industry can change the world.

Second, it's the ethics and values we live and lead by. And third, it's safety. In fact, with regard to our safety record, I don't know of another company today with a better safety record than our own within or anywhere outside our industry. Safety and respect for others are at the core of our value system.

We went into the downturn as the premier climate control company. And a relentless focus on continued high employee engagement will enable us to emerge on the other side of this downturn even stronger. Since the crisis, we've gone at great lengths to keep our people safe across the globe. It's not just about strict PPE protocols, dramatically increasing cleaning and disinfecting, we're implementing employee active screening and safe distancing protocols.

It's about fundamentally rethinking the way tens of thousands of people conduct their work in our offices, factories and warehouses, and then reconfiguring them for safe distancing through actions, such as reconstructing and rebalancing production lines, radically adjusting material and workflows, and investing in new equipment to adjust for new lifting and positioning requirements, and in every facet of how our people work and move through our facilities. We are also actively helping our employees and communities with financial assistance through this challenging time through supporting national and local community organizations and through our employee-funded Trane Technologies Helping Hands Fund.

We are in a strong financial, balance sheet and liquidity position, and will continue to generate powerful free cash flow. We will utilize our strength to play aggressive offense throughout the downturn. We have a strong management team, a proven operating system, and confidence we can execute our downturn scenario playbook to limit decrementals in line with our gross margins.

We announced the RMT transaction with Gardner Denver early in 2019. By mid-2019, well ahead of the pandemic, we created an office of transformation that reports directly to me, blueprinting the organizational design and developing transformational margin improvement opportunities for the pure-play Trane Technologies of the future. The stack of projects related to these margin improvement opportunities are progressing well and many are already underway.

We're looking forward to discussing these opportunities in detail at our Analyst Day, which is still slated for the fall, whether that's in person or virtually. The transformation office also oversees a stranded cost reduction programs. And this downturn has created an opportunity to accelerate the elimination of stranded costs. We have now identified $90 million in permanent structural cost savings that we expect to take effect in 2020 with run rate savings in 2021 of $110 million.

Lastly, I personally find it useful to continue to look at the future through a holistic sustainability lens. First, sustaining the health, welfare, personal development and future of our talented people around the world. Next, keeping our communities safe, healthy and thriving. And finally, of course, business sustainability, which means managing the business for the long term, including the opportunity we have to invest and build our capabilities even in this downturn so that we can emerge with an even wider competitive advantage. We have a tremendous opportunity to make this happen. In fact, looking back at the last downturn in 2008, we couldn't be in a more different and preferential position in comparison or better suited to capitalize on our advantages.

Now I'd like to turn the call over to Dave to discuss COVID-19 and our proactive response to the crisis in more detail. Dave?

David S. Regnery, Trane Technologies plc - President & COO

Thanks, Mike. Please go to Slide #5. During the quarter, the pace at which the COVID-19 pandemic changed the economic landscape is unparalleled, moving from region-to-region, impacting our employees, customers and communities as it spread.

For Trane Technologies, we began in early January forming crisis management teams to confront the pandemic with employee safety as our #1 priority. As we moved into February, we closed all our facilities in China. We proactively began addressing employee safety. As Mike alluded to on the previous slide, the safety measures were more than just providing PPE. We took a holistic look at how we work. Our teams proactively reconfigured our facilities to address the pandemic. We changed the way production lines flow, the placement of machine operators and created physical barriers, where necessary. We implemented active screening, staggered break times, increased cleaning measures and frequency of cleaning measures and expedited PPE.

By March, as we ramped up production in China with protective measures in place, the work of reconfiguring our facilities moved to EMEA and the Americas. We proactively sent employees home and ensured their pay would be held whole to reduce the number of employees in our facilities to deliver essential customer orders only. This increased the safety for our employees and greatly reduced our facility output to provide time to implement the necessary safety measures fully in each facility. To be clear, these safety measures were not limited to our plants. We proactively addressed employee safety in our distribution centers, offices and parts stores. All facilities were in scope.

By the time April began, our plants in Asia Pacific completed their ramp-up. Our plants in EMEA and the Americas began to ramp their production. And we expect most plants will be fully ramped early in May. Throughout the quarter, our supply chain crisis management team proactively worked with our suppliers as they addressed their own COVID- 19 challenges. The team continues on a daily cadence to manage potential risks. This team has done an excellent job. As we move into May, we are running with new line rates and protocols and adjusting to meet customers' demands.

Please go to Slide #6. From the start, Trane Technologies has been addressed in the crisis by bringing expertise, technology and services to bear on critical applications for hospitals and other health care facilities, like clinics, research laboratories and pharmaceutical production. By ensuring proper air treatment, filtration, ventilation and decontamination, we're helping to keep patients and health care workers safe and more comfortable in the most challenging situations. We're providing and maintaining

indoor air quality through solutions such as Trane Catalytic Air Cleaning Systems, which remove pathogens from air streams, and negative pressurization systems to isolate infections.

Our remote monitoring, controls and building intelligence solutions are increasingly important in an environment of social distancing. These technologies enable technicians to remotely monitor, inspect and troubleshoot systems to keep critical environments running safely and efficiently. Our transport refrigeration solutions are protecting the cold chain and helping to ensure the safe and reliable delivery of perishable food, medicines and other critical goods.

Through telematics, we're putting data to work with the ability to track and trace deliveries across fleets, monitor the location of assets and the temperature of individual deliveries in transit.

Please turn to Slide #7. Trane Technologies has been addressing the impact of the pandemic on our communities.

Established a number of years ago in response to natural disasters and funded by donations from our own employees, the Trane Technologies Helping Hand Fund is providing financial assistance to our own team members around the world dealing with financial hardship as a result of the pandemic. According to our Feeding America partners, food donations in this environment have declined by nearly 60%. In response, through our Trane Technologies Foundation, we made a $100,000 contribution to Feeding America. And our team stepped up to help out with the effort. In one example, our Thermo King and Commercial HVAC Americas team joined forces with Feeding America and A Hand Up International to host 2 drive-through pantries in Lynn Haven, Florida, providing more than 120,000 pounds of food to nearly 6,000 people. Additionally, teams are upgrading operating rooms, air handlers, preparing patient isolation areas and expanding COVID-19 treatment facilities for hospitals in record time. I am proud of how our team focused on employee safety and supported our customers and communities in response to this crisis. And I am confident they will continue to address the challenges presented by the pandemic as we move forward.

And now I'd like to turn it over to Chris to discuss our balance sheet and liquidity position. Chris?

Christopher J. Kuehn, Trane Technologies plc - Senior VP & CFO

Thanks, Dave. Please turn to Slide #8. As Mike mentioned at the outset of the call, we are operating from a position of financial strength as we move through unchartered territory in 2020. We have a strong balance sheet, excellent liquidity and have maintained solid investment-grade ratings over many years.

Additionally, our consistent track record of delivering free cash flow of equal to or better than 100% of adjusted net income over time, with a 5-year average of 107%, including an outstanding year in 2019, which delivered 118%, further bolsters our strong financial position. The timing of the close of the Reverse Morris Trust transaction with Gardner Denver on February 29, 2020, and the receipt of $1.9 billion in cash also provided significant liquidity, owing to the rapid pace both organizations tirelessly worked to finalize the transaction in 10 months' time. That money has been received and is reflected in our March 31 cash balance.

In addition to cash on hand, we have full access to our revolving credit facilities. The first $1 billion facility expires in March of 2021, and we expect to refinance this prior to maturity. The second $1 billion facility matures in April of 2023. Even if we were to fully utilize both facilities, we would remain well below our primary debt covenant of 65% debt to capital. Both facilities were undrawn at March 31 and remain undrawn today. Lastly, we run a relatively CapEx light business model, so our capital requirements are pretty modest at around 1% to 2% of revenues.

Now I'd like to turn the call back over to Dave to provide details and color on what we saw in our end markets in the first quarter. Dave?

David S. Regnery, Trane Technologies plc - President & COO

Thanks, Chris. Please turn to Slide #9. Broadly speaking, our HVAC markets remained healthy in the first quarter with pre-pandemic bookings and revenues largely in line with our full year expectations. As the pandemic progressed across the globe, bookings and revenue were heavily impacted, first in Asia Pacific,

followed by EMEA, then the Americas. In each region, our proactive safety measures temporarily limited our uptime and our utilization. Despite the pandemic, our Commercial HVAC Americas business delivered strong broad-based growth with bookings up mid-teens and revenue up mid-single digits. We saw strong demand in data centers and from institutional customers across education, government and health care. Our Residential HVAC business also saw strong demand with bookings up mid-single digits. With strong bookings growth in Commercial and Residential, Americas HVAC backlog was up double digits versus first quarter of 2019. The majority of the backlog is applied systems, which typically have lead times of 6 to 12 months. Our Transport business was heavily impacted by the pandemic in each region, accelerating declines already expected from the correction cycle that began last year. I'll give a more detailed update on our Transport business later in the presentation.

With the COVID-19 pandemic impacting EMEA for most of March, our team saw low single-digit declines in both bookings and revenue. Despite the pandemic, Europe Commercial HVAC bookings and revenue were up low single digits. During the quarter, Asia Pacific was hit first and hit hardest by the pandemic with bookings and revenue down double digits. Given the pervasive impacts of the crisis, I'll give additional insights to our end markets later in the presentation based on order patterns we saw in the month of April.

And now, I'll turn it back to Chris to discuss the results for the quarter. Chris?

Christopher J. Kuehn, Trane Technologies plc - Senior VP & CFO

Thanks again, Dave. Please go to Slide #10. The onset of the COVID-19 pandemic significantly impacted our first quarter financial results as we took actions to protect employees and customers. As Dave mentioned on the previous slide, prior to the pandemic, our global revenues in the first quarter started off largely in line with our full year expectations. However, pandemic impacts limited our global equipment and service revenues by approximately $150 million in the quarter with almost 2/3 of the impact in Asia Pacific, contributing to our 5% organic revenue decline.

Adjusted EBITDA margins were down 60 basis points in the quarter primarily due to margin impacts from the volume declines related to both the pandemic and the Transport correction cycle. Negative product mix in the Americas more than offset positive price versus cost, as we delivered mid-single-digit revenue growth in Commercial HVAC as compared to approximately 30% revenue declines in Transport. We implemented proactive cost controls across the business and accelerated our stranded cost reduction actions, contributing to a $16 million reduction in unallocated corporate costs and positive productivity versus other inflation in the quarter.

Please go to Slide #11. During Q1, we delivered enterprise deleverage within gross margin rates on lower volume by managing all elements of the P&L, including our decisive actions to accelerate cost reduction programs. Within the Americas region, our Transport revenues were down approximately 30% as the correction cycle in the end markets was accelerated by the pandemic. Americas margins were heavily impacted by both the volume and mix impacts of the Transport revenue declines.

Given the size of our Americas operations, our commitment to proactively invest in employee safety and security in our plants, distribution centers, offices and parts stores added necessary costs and reduced absorption in the quarter, negatively impacting margins. Margins in EMEA and Asia Pacific were both impacted by top line headwinds related to the pandemic. In each region, swift action and strong execution of cost reduction programs limited deleverage to within gross margin rates.

Please go to Slide #12. As Mike discussed in his opening remarks, given the onset of COVID-19, we're aggressively stepping up our efforts to remove $100 million in stranded costs related to the Reverse Morris Trust transaction we closed in Q1. After announcing the transaction in April last year, we quickly mobilized a margin improvement and transformation office by mid-summer to focus on these cost reductions, which gave us a nice head-start in determining the best, most value-accretive ways to eliminate these costs while simultaneously improving the overall capabilities and margin expansion opportunities across our businesses. They quickly moved to implement zero-based budgeting processes and principles across the company.

Entering 2020, we set a cost reduction target of $40 million in the year of the total $100 million in stranded costs. We looked for opportunities to accelerate the pace of savings in the first quarter, and with the onset of COVID-19, saw an opportunity to push ourselves further. To date, we have identified savings of approximately $90 million to be realized in 2020, more than double our original target. Further, heading into 2021, the actions we will have taken in 2020 should yield permanent run rate savings of approximately $110 million in 2021. Of the total $90 million savings in 2020, we expect about $70 million to come from corporate unallocated expenses and approximately $20 million to come from the segments. Lastly, we previously disclosed we would incur one-time costs of approximately $100 million to $150 million to permanently eliminate the $100 million in stranded costs, and the table on the bottom right of the slide shows our status to date. We spent approximately $31 million in Q1. We'll update you quarterly on our progress.

Please go to Slide #13. We remain committed to balanced capital deployment going forward as we have consistently done for many years. Given the unpredictability of depth and duration of the downturn related to COVID-19, we wanted to highlight the modest adjustments we have made for 2020, and equally important, highlight the things that have not changed. As Mike outlined, we are going to manage through this downturn from a position of financial strength. We see this as a time to lead and a time to aggressively invest in our most important asset, our employees.

We also see this as a time to aggressively invest and to solidify or extend our market-leading positions through value accretive investments that will make us an even stronger company coming out of this crisis than when we went in. Importantly, we expect to maintain our dividend at current levels for 2020 and have already paid the quarterly dividend for the first quarter and declared the quarterly dividend for the second quarter. We expect to pump the brakes on share repurchases in the second quarter while maintaining optionality down the road.

Regarding debt obligations, we committed to and paid $300 million in April to retire debt at maturity. And we expect to pay down the next debt obligation of $300 million at maturity in February of 2021. We will continue to evaluate strategic, value-accretive M&A. And lastly, we expect to maintain a strong investment-grade credit rating. This offers us continued optionality as markets evolve.

And now I'll turn it back to Dave to give an update on current Q2 trends. Dave?

David S. Regnery, Trane Technologies plc - President & COO

Thanks, Chris. Please go to Slide #14. During the month of April, we've seen global orders down approximately 20%. Looking across the regions, orders in the Americas and EMEA were both down over 20%. Asia Pacific orders were also down, but under 20% as China demand is near prior year levels. Given the normal seasonality of our business and continued deterioration in economic indicators, it is unknown if these order trends will further deteriorate, stabilize or improve.

In the Americas, demand for our commercial applied products has been more resilient, particularly for essential end markets, including warehousing, data centers and health care. Unitary demand has been softening. Broadly speaking, during a downturn, our service and parts businesses typically see strengthening demand as customers choose to extend the life of their HVAC equipment rather than replace it. Since this downturn is driven by a pandemic, traditional HVAC services and parts demand have been limited due to access constraints at customer sites. Conversely, the pandemic has driven additional demand for our intelligent services, which include remote building monitoring and indoor air quality offerings.

In the residential market, approximately 80% of our sales are replacement units. Impacts from the pandemic have caused declines in consumer confidence and increases in unemployment, our 2 main replacement market indicators. Though the overall demand is down, we are seeing orders for both lower SEER products that appeal to value customers and higher SEER products that appeal to customers looking to improve indoor air quality as more people are working from home. I'll speak about our Transport market outlook on the next slide.

Our EMEA markets are seeing similar disruption to what we are seeing in the Americas with France, Italy, Spain and Portugal being significantly impacted. In Asia Pacific, China demand is near prior year levels

while market demand in India, Singapore, Malaysia and Japan remain restricted. From an operations standpoint, we continue to proactively invest in employee safety across our facilities. Our plants in Asia have ramped up, and our Americas and EMEA plants are ramping as we speak.

Since China was the first area to be significantly impacted by COVID-19, we have received questions asking what lessons we've learned from our efforts in this region. Our #1 learning was that early proactive safety measures are absolutely paramount, and we have rolled out these measures globally. Second, consistent, focused supply chain cadence is critical to support equipment production and service delivery. Those processes have been effective and implemented globally. And our final learning is that no two countries are the same. At this stage, it is unclear if other countries will track to a similar recovery path as China, given the varied regional response to the pandemic. Finally, as we highlighted in our earnings release this morning, we're temporarily suspending our formal guidance and expect to reevaluate for Q2 earnings.

Please go to Slide #15. COVID-19 has created obvious disruptions in the majority of our end markets as outlined on the prior slides. The near-term impacts on the transportation markets have been even more significant. On our Q4 call, we provided a good level of detail on our expectations for the transportation market in 2020. Today, I would like to dive a little deeper and provide market forecast for North America and EMEA for each of the major product categories with truck, trailer and APU broken out separately.

The COVID-19 impacts on the transport markets in 2020 are pronounced, with dramatic forecast reductions across all major product categories in both North America and EMEA. For North America, the trailer forecast has dropped from down 25% in January time frame to down 46% as of a week ago. The North America APU forecast has moved from down 33% to down nearly 60% for 2020 while the truck forecast has dropped from down 3% to down nearly 20%.

Likewise, Europe truck and trailer forecast declines have nearly doubled as well. Additionally, while we don't have the same level of reliable, detailed forecasts available for the other businesses, including marine, bus and rail, these markets are down similar numbers as well.

As you might expect, COVID-19 has dramatically slowed global demand in food distribution, which support hard-hit businesses like restaurants. And long-haul trucking has been significantly impacted by the slowing of the overall global economic demand and cross-border shipping. Aftermarket parts is showing resilience, and demand is expected to continue to be solid as companies look to extend the life of their existing fleets.

In terms of the timing of the pandemic impacts on Transport, we were generally seeing encouraging booking rates through the first 2 months of the year that supported our initial Transport outlook for 2020 that we provided on our fourth quarter earnings call. As we moved through March and the pandemic started shutting down major portions of the economy, booking rates dropped significantly, consistent with the updated forecast view on this slide.

To date, in April, we're seeing very slow bookings as most trucking companies have hit the pause button on activity to reflect the significant downturn in the economy and across major sectors of the refrigerated truck, trailer and APU markets, as I discussed earlier. The forecast for the second quarter for North America trailers, for example, is down approximately 80% from 2019. April-to-date, our bookings across Transport Americas for equipment is down about 80%, which is consistent with that outlook while aftermarket is relatively flat with prior year. The ACT forecast has been revised lower several times since the pandemic hit. So it's really too early to call how 2020 ultimately will play out. As states reopen and economic activity gradually returns to normal, we expect demand to significantly pick up from current levels as well. ACT initially called for a market correction in 2020 and then a return to growth in 2021. And that still seems directionally correct, although COVID-19 impacts are likely driving a deeper and more prolonged market correction, and a more cautious and gradual return to growth.

And now I'll turn it back to Mike.

Michael W. Lamach, Trane Technologies plc - Chairman & CEO

Thanks, Dave. Please go to Slide 16. Our strong financial condition, balance sheet and liquidity enables us to operate from a position of strength throughout the COVID-19 crisis as demonstrated through 2 significant revenue downturn scenarios: the first, down 15%; and the second, down 25%. And to reiterate, because I've heard there has been some confusion on other company earnings calls, these are not our forecast, they're just scenarios. We want to have a response under any scenario, given the tremendous uncertainty that exists in the near term. And we want to assuage investor concern by showing a breakeven free cash flow analysis in the minus 25% scenario.

What's important to note, however, is that in both scenarios, we have the financial strength to weather the storm, pay dividends and continue to follow our core principles. We are going to remain true and uncompromising to our purpose-driven sustainability strategy and our core values, including employee safety and well-being and corporate citizenship in our communities. Anyone who knows our company and our culture knows that this is something we believe in at our core. It's who we are and it's how we win. It's what has driven strong shareholder returns over the past decade since the last downturn and what we believe is a proven formula for sustainable, strong shareholder returns in the future.

We're also going to play aggressive offense. We see this downturn as an opportunity to invest, expand market share, extend our leadership as the premier climate control company and to emerge from the crisis even stronger than when we went in. We're going to continue to execute our playbook and take appropriate cost actions and we're going to be very strategic in our application. Our objective isn't to maximize 2020 earnings, it's to build the Trane Technologies of the future and to win big over the long term.

Please go to Slide 17. Our long-term strategy remains unchanged and is underpinned by strong secular sustainability mega trends. Our end markets, our strategy and our products and services are all tied to the undeniable facts that the world is getting warmer, cities are becoming more densely populated and the demand for fresh food is accelerating.

Fundamentally, we excel where these global mega trends and sustainability intersect with our innovation and capabilities, which drives high demand for our products and services. And while short-term demand may be impacted or pushed out, longer term, the challenges these secular mega trends present will not abate and will require leadership and action post COVID-19.

We also know that the post COVID-19 world will evolve and adapt the new reality and experiences we've gained through this crisis. Accurate design, installation, service and monitoring of HVAC systems will be more important than ever to ensure proper filtration, ventilation, air flows and pressurization in high-density areas and especially in critical environments like hospitals, food and pharma, office buildings, hotels and homes, buses and other modes of mass transportation. Remote monitoring, diagnosis and artificial intelligence-based service models have the potential for exponential growth and new service models will emerge. These are just a sliver of the potential opportunities we see now and we intend to evolve, adapt and capitalize on them.

In the near term, we strongly believe it's imperative that premier companies like Trane Technologies lead through this crisis authentically, steadily and with a sense of purpose. We will remain true to our strategy, built on the fundamental building blocks that drive sustainable, differentiated financial performance for our shareholders now and in the long term. We also see this downturn as an opportunity to invest, expand market share, extend our leadership and we'll emerge with an even stronger culture and a stronger company than ever before.

Even in the current crisis, we're confident and excited about the future of Trane Technologies and our ability to bring all of our considerable resources to bear to deliver strong, sustainable returns for our shareholders. I want to thank our dedicated employees around the world for supporting all that is essential to fight this pandemic, and all the frontline caregivers that are heroically battling for all of us every day.

And with that, Chris, Dave and I will be happy to take your questions. Operator?

QUESTIONS AND ANSWERS

Operator: To ask a question at this time, please press star, then the number 1 on your telephone keypad. We will limit questions to 1 question and 1 follow up. We will pause for just a moment to compile the Q&A roster. Your first question comes from the line of Scott Davis from Melius Research. Your line is open.

Question – Scott Reed Davis: Hi good morning guys hope you can hear me okay [we can]. Well, thanks for the detail, it's super helpful. But I'm kind of intrigued by this whole indoor air quality theme overall. And I guess the question really is what -- do the building owners care? Is there a sense of urgency outside of -- obviously, hospitals have always cared. But when you think of the other categories that you sell into, is there – you know are your phones lighting up that people say, "Wow, we need to do a retrofit project here"? Or is it just too early to really say?

Answer – Michael W. Lamach: Yes. Scott, it's too early to say, but we're looking at just sort of human behavior and the lasting effects of what a pandemic would do to society. And we see a little bit happening through our lens in China, although you can't draw exact parallels between the 2. One thing for sure is that the ability to really monitor indoor air quality and to design and make sure that from a maintenance perspective and all the controls and automation that go into making sure that it's effectively working, I think you're going to see sort of more density per square foot of all that and perhaps codes that in some parts of the world, which may have not been up to a particular standard, I think, will change. As will food transportation, codes and standards change, I think, going forward as well.

So probably, when you get through this, it puts an importance. And I think particularly as buildings become tighter and tighter in terms of their design, I'm talking about the envelope with the building, it's so critical to make sure that you're having fresh air exchange in the building. A typical building, depending on what it does, might have half a dozen to dozens of 100% air changes in an hour. And the ability to make sure that, that's happening and that you're killing pathogens where you can in the system or pressurizing appropriately or diffusing air or diluting air is going to be even more critical. So I think it bears a lot of opportunity going forward. I mean it's hard to -- we need to get through this right now, but I think the other end of it probably has more opportunity than not.

Question – Scott Reed Davis: Okay. Good. And then I'm just kind of curious of the confidence that you have in your backlog. I would assume a certain percentage of your backlog includes things like hotels and stuff like that, that I would think are at risk of not just delays but cancellations. So perhaps just a sense of what your confidence in the backlog is overall.

Answer – David S. Regnery: Scott, this is Dave. I'd say we're pretty confident in our backlog, especially in the HVAC space. A lot of it is in the applied world. We haven't seen a lot of cancellations there. We actually haven't seen very many at all. It's pretty normal. Our TK backlog, a little bit more concerned with that. We have seen some cancellations, but it's pretty low right now. So overall, I'd say we're pretty confident around the globe in our backlog, and we haven't seen anything that would lead us to believe that, that won't happen.

Answer – Michael W. Lamach: Yes. Scott, if you think about -- you mentioned hotels, but you could throw light retail, that's a small part of our business. I mean retail as an example, we've never, over the last decade, focused much on national accounts at all as an example. And so if you think about our relatively high share in unitary and light unitary, the smallest share by design we would have would be in retail. And if you go into hotels, the place where we play in hotels is sort of in the lobby and in the common areas and in the larger and more complicated spaces we really don't play in sort of individual rooms. And so the vacancy of a hotel isn't going to matter. If the hotel is open, we're going to be providing equipment and services. So that is a little different. Maybe a decade ago, I would have said we would have had more focus on retail national accounts. And that's changed over the decade.

Operator: Your next question comes from the line of Jeff Sprague from Vertical Research**.** Your line is open.

Question – Jeffrey Todd Sprague: Thank you good day everyone. Just first on the kind of working through the scenarios and what you're planning to do. Just want to be clear, the comment about managing the decrementals around gross margin would require extra actions. Are you planning to take

those actions? Or are you suggesting to us that none of us has a crystal ball, but pick a revenue scenario and we should expect your decrementals to be around your gross margin rate?

Answer – Michael W. Lamach: Yes. That's a great question. And the first thing I would tell you is that anybody that thinks they're going to forecast a number is only going to be surprised when the forecast meets the real world, the first minute. So the notion of really doing scenario planning is something that we've been living with for a long, long time. And although we would have done scenario planning in the past, it would have been around a general recession. So pandemic is something new with regard to just the behavioral changes in the way that, say, in our case, buildings would even be closed or limited in terms of access for service. And so the pandemic has offered really a sort of a different scenario. But once you move through the initial pandemic phase, and we think through to Scott's earlier question, where the opportunities lie going forward, it's more useful than to think about scenarios and what ultimately will be a recession, of course. I mean we're in one now, we just don't the depth and duration of that recession. So for us, we've looked at, I would say, increments of 5 points of revenue decline, one of the series of actions that we need to take on top of the actions already taken. And so having those lined up in advance and having a playbook to do that gives us some confidence that we can maintain within plus or minus a reasonable amount gross margin decrementals would be in line with that. But in doing that, we don't think there's an opportunity that we want to miss about investing or even doubling down in areas of innovation and technology and channel, or doubling down in areas of productivity because the key to this for us is we entered this thing, I think, with a pretty wide gap relative to some of the competition, and we want to come out of this with an even wider gap. And we've never been in a better position from a liquidity and a talent and a technology perspective to be able to do that. So it would be a tragedy not to really invest. But all that being said, I think we can do 2 things at once. We can manage the decrementals and we can continue to really double down the important investments for growth and productivity.

Question – Jeffrey Todd Sprague: And as an unrelated kind of follow-on second question, Mike, you mentioned M&A kind of prominently in your press release this morning and in the slides. Can you give us a little thought of what you're thinking, what you're interested in, kind of the priorities for the newco on a stand-alone basis here?

Answer – Michael W. Lamach: Yes. It's always the strategy is what needs to drive M&A. And so the ideas that we would have 80%, 90% of the ideas that we would have would be really defined by the strategy. And that hasn't changed around technology and channel for us. And they tend to be really in buckets. It's the easy bolt-on technologies that need a channel or it's the channel that adding our technology would make that channel really work. Those are easy for us to do. I would tell you that, that is something that we're still very active with. I think on some of the larger, more transformative things that a company could do like ours, I think the bid-ask has widened in this environment. But it makes sense over time really to have liquidity and the balance sheet to be able to look at those sorts of things if, in fact, the bid-ask narrows and in fact they become attractive. So we would keep all options on the table. And again, this is about playing aggressive offense where we can. In a way, Jeff, our timing was unlucky. We caught a large acquisition and had a hung bridge loan in April. And we couldn't have been in a worse position. And then you fast forward and between announcing closing the RMT transaction in 10 months, our luck couldn't have been any better. And so we really need to capitalize on that good fortune and make sure that we're parlaying that into a really good future that we can invest for the long run.

Operator: Your next question comes from the line of Steve Tusa from JPMorgan. Your line is open**.**

Question – Charles Stephen Tusa: Hey guys good morning. What was, in total, Thermo King down on revs for the quarter?

Answer – Michael W. Lamach: Americas, I think, Dave said down...

Answer – David S. Regnery: Americas was down about 30%. And EMEA was down about 10% -- 15%, I think it was.

Question – Charles Stephen Tusa: Okay. Got it. And I think you guys had said that the total, you said something about mid-single-digit growth in commercial. Was that the total commercial business in the quarter?

Answer – David S. Regnery: We talked about the EMEA -- I mean, I'm sorry, the Americas number was up the mid-single digits, correct. EMEA was slightly down. And that was really driven by the Middle East. Actually, Europe was up. And Asia Pacific was the hardest hit, Steve, by the pandemic as it obviously hit there first and it was down double digits.

Question – Charles Stephen Tusa: Right. And in global services, you mentioned it was weak kind of across the board. What was that for globally, just services for HVAC?

Answer – David S. Regnery: Obviously, it was down in Asia Pacific. Globally, it just did not perform as well as we thought it should have, actually flattish in the Americas. But again, we expect more out of that. And we have had some disruption getting on job sites, really in all aspects on the service business, whether it be service agreements, whether it be break/fix, we have had some disruption. But with that said, Steve, I want you to take away, we also saw some opportunities on it with our intelligent services. And we've been at it a long time getting buildings connected. And we have over 20,000 buildings connected now and really seeing the benefit there. Customers are really seeing the benefit of being able to have those buildings serviced remotely and diagnosed if there's something wrong. As Mike said, indoor air quality in buildings is obviously there's a lot of talk about that. It's a very important aspect of our business. We're really good at it. There's a lot of science around it. And as office buildings around the world start ramping back up, our service techs are on call to make sure we could help our customers.

Question – Charles Stephen Tusa: All right. One more quick one, just on the earnings bridge. Kudos to you guys for giving some sub-segment detail. Mike, thanks for that. But you guys don't give the earnings bridge anymore. What was kind of price material inflation on a margin basis year-over-year this quarter?

Answer – Christopher J. Kuehn: Yes, Steve, this is Chris. We were positive on a price and a cost basis on the margin bridge. And to your comment, I think that margin bridge has really served us well in the past when we've had, especially the last couple of years, higher tariffs and higher inflation. Consciously, going forward, we want to make sure we can tell the story what's happening on a quarterly basis. So we want to make sure we do that without the confines of a bridge. But to your question, price/cost was positive in the quarter, productivity was positive versus other inflation, although that's where we also saw some of the investment in our COVID-19 measures.

Operator: Your next question comes from the line of Andrew Kaplowitz from Citigroup. Your line is open.

Question – Andrew Alec Kaplowitz: Hey Good morning guys thanks for all the color. Mike, China, back to flattish demand year-over-year is relatively quick. Can you give us more color on the type of demand you're seeing? Is it more the indoor air quality products and service as buildings need to be serviced? Or is it more delayed larger orders coming back?

Answer – Michael W. Lamach: Yes. I'm going to, Andy, give that to Dave here. But let me kick off just a thought kind of going forward. Our business in China really is on institutional, large commercial equipment with a growing service business. That service business is 1/4 to 1/3 of the mix, which, of course, was heavily impacted. So we recognize revenue when we ship like a chiller or we recognize revenue when we complete a service engagement and bill the client. There's very little progress billing or percent complete accounting that would go on, to smooth that out. So it would look outsized for us because we weren't shipping chillers. I mean, conversely, the backlog of chillers to ship in China is fairly substantial. And I think what Dave will tell you is that, we're seeing it return back to prior levels at this point.

Answer – David S. Regnery: Yes. I mean we have -- the incoming order rate for April was -- actually, as we're still rolling up the numbers here, let's say, it's going to be a little bit favorable to last year. There is probably some pent-up demand there. I would tell you though that as we track our pipeline, and this is the orders that haven't yet been booked, but they're actively being quoted, the pipeline is actually starting to show positive movements as well. And that's really what we start looking at as the pipeline because that's a really good indicator as to what future activity would be. We're still watching it, but April was -- April is a good sign and certainly a lot of attention to it in the rest of the quarter.

Question – Andrew Alec Kaplowitz: So that's very encouraging. I did want to follow up on services. You mentioned it being flat in Q1, a little disappointing. Is services going to outpace the 20% decline that you're talking about for Q2? And do you see services start to snap back as economies start to turn on? Or is it too early to see that at this point?

Answer – David S. Regnery: Yes. No. I mean maybe a little bit early to see that. But first of all, your first question, yes, we do see services outperforming the equipment in the second quarter, so it will not be down 20%. We expect that to be more in the flattish range. Your second question, do we see opportunities in services? Absolutely. One of the things that, as we talk about our playbook if we have a downturn, one of the things that we're protecting is our expertise in service really around our service technicians. We're kind of ring-fencing that to say that's an area we're not going to go if we're going to try to cut costs. We're protecting that because we know that as the economy snaps back and individuals start going back to offices to work, indoor air quality is going to be super important and how you're able to help those customers understand indoor air quality and have solutions for them, we're really going to leverage our service business in that way.

Answer – Michael W. Lamach: And Andy, I would say that clearly a service business is not an antidote to a pandemic. It is an antidote to recession. And as we move through pandemic concerns now into whatever the new normal would be going forward for building occupancy and services, absolutely we would expect to see, as we have in every downturn, every recession, you're going to see capital extended. And here, in particular, you're going to have large commercial, large institutional customers looking at making sure the air flow, air change, diffusion, dilution, pressurization, filters are all going to be in tip-top shape. So really for us, I think that, that's going to, to Dave's point, require every technician we've got and it's going to require more connected buildings because customers are going to want that service as opposed to people that don't need to be in your building, right? I mean there's no point in coming out to a facility if you don't need to, if you can diagnose it first in advance and maybe even fix it remotely, which often we can do, that's going to be an opportunity. And that's a great way for us to deliver service at even higher margins than physically delivering services.

Operator: Your next question comes from the line of Julian Mitchell from Barclays. Your line is open.

Question – Julian C.H. Mitchell: Hi good morning. Maybe just a first question on the decremental margins. So understood that firm-wide, you're aiming for that or think you can hold the line at that sort of 30%-ish level like you had in Q1. But clearly, I think mix can play a massive role in swinging that round. Your Americas decrementals in Q1 were quite a bit higher than the gross margin, for example. So maybe help us understand what mix assumptions you have for the balance of the year and whether you are very confident that you can offset swings in mix with cost actions.

Answer – Michael W. Lamach: Yes. Julian, first of all, in Americas, somewhat $40 million revenue differential. So the absolute dollars are relatively small for the size of the business. Actually, the decrementals there, the cause – the first cause was not the mix with Transport or the mix of service. It was really the response we took with regard to the COVID crisis. And just to give you a sense, if you ever wonder if we actually walk the talk in terms of what we say about our values around safety, we always think about March being half of the quarter and we always think about the last week of March being half of March. And 1/4 of our quarter, if you follow all that math, is the last week of March. We actually pulled the end on the cord March 23 and shut down all of our factories in Europe and in the Americas and prioritized only the orders that were essential going into fighting COVID. And that would have ranged in 10% to 15% of the orders. We had a couple of factories where, for a short time, it might have been 40% of the orders. During that time, of course, you lose that absorption. But when we sent people home, we sent them home and topped up their pay to make sure they were paid their full wages or the equivalent. And so any gap with any unemployment benefits would have been topped up. We made all the wage increases around the globe for any hourly associate or any service technician proceeded as planned. So we didn't delay those. We actually put them through as planned. We reclassified our medical plan so that COVID testing and preventative care would be at no cost to employees and that telemedicine visits would be added at no cost to our employees. We amended our 401(k) plan. So not only did we not cut our 401(k) match, we amended our plans to make sure that people could take out up to $100,000 in delayed loan repayments for a year. We provided backup childcare and elder care programs for people with

minimal, very small copays so that they could come to work or take some of the stress off. We extended our employee assistance program to -- with programs for financial, emotional, legal, other support and hardships. And so all those things are things we took. But the biggest cost was taking some 25,000 jobs and literally reconfiguring all the lines and workstations and then making sure we had all the PPE in before people came back to work. And so all of that was so that we can go faster in the long run and people would feel safer. And when people feel safe, they come to work. There's not absenteeism. We're not shutting down factories to clean them. And that is where the costs came in. So you look at the job in Asia or the job in Europe and the deleverage in the teens and look at the Americas on the small revenue kind of a decline of $40 million, and I don't want anybody to read too much into that. So before we start talking about taking costs out of which we've got all the actions loaded and we can talk about that if you'd like, you have to think about sort of doing the right thing, which is what we did and what we always would do. And we will do -- and I would make that decision every single time if given that decision again.

Question – Julian C.H. Mitchell: Thank you that's reassuring to hear. Maybe just one quick follow-up and maybe it's for Michael or for Chris. On Slide 16, you've got the helpful scenarios laid out. If I look at, say, scenario 1, sales down about 15%, flows through the decremental you have talked about, so maybe it's a 30% drop in EBIT or EBITDA, it looks like in that scenario, the free cash flow decline is maybe a bit heavier than the operating profit decline. Just wondering if I had that correctly. And whether I did or not, what you're assuming for working capital within those cash flow scenarios.

Answer – Michael W. Lamach: Well, I'll start, Julian, this is Mike. Yes, I would tell you that if you go back to the '09 time frame, I want to say we were 3x, 3x, 3x-plus cash to net income. So we know how to get cash out of the business in a significant downturn. So I would look for extraordinary operating cash flow in a down 25% scenario. Just so if you go back to the '09 time frame, you get a proof positive on that point. So I'm not sure if that analysis that you're doing would be correct in that regard. Chris, do you want to add to that?

Answer – Christopher J. Kuehn: Yes, I'll add. I mean there's maybe a little bit of what I'd call a little conservatism in the numbers as well. We're still investing capital at the normal levels you would have of 1% to 2% of revenues in both of those scenarios, Julian. Whether the investment is in employees or capital or otherwise, that cash is there to go fund. So we can certainly talk offline, but I think that's a reasonable scenario for us right now, a little bit of conservatism in there.

Operator: Your next question comes from the line of John Walsh from Crédit Suisse. Your line is open.

Question – John Fred Walsh: Hi good morning. Wanted to go back to the service conversation and maybe find out how much of that business is really driven by contractual service versus needing to get on to the site and generating some type of spare part or something to drive the revenue.

Answer – David S. Regnery: Yes. John, it's a good question. On a contractual basis, our service business is about 30%, okay? And within that 30%, there's lots of different service contracts that we have. We have a whole portfolio of different contracts. So some include parts, some do not. So there is some parts demand that's generated from that 30%. And then you move into the break/fix world, where it's broken, they give us a call, we come out and we fix it. And then you also have a planned maintenance, where you'll actually proactively plan with the customer to do a major replacement or a major overhaul on a piece of equipment.

Answer – Michael W. Lamach: John, it breaks out to about even thirds on the service business. If you look at it that way...

Answer – David S. Regnery: Yes, a 1/3, a 1/3, a 1/3.

Question – John Fred Walsh: Okay. And then obviously, in the Americas, depending on what state you're in, there's different rules around construction. But curious, once again staying on the service topic, what do you see in those states where there's a big shelter in place order and only essential work is getting done versus states where the restrictions might not be as stringent? Are you seeing a real big bifurcation in how the businesses are acting in those? And is that the way to think about going forward?

Answer – Michael W. Lamach: Yes, John, what I'd say, more than anecdotally, is if somebody is calling for service in the Americas right now, they're going to be in a critical infrastructure, a critical, essential role. So we're not getting phone calls from somebody that's not operating or not running. So we're in hospitals, we're in pharma, we're in food and bev. We're in...

Answer – David S. Regnery: Data centers.

Answer – Michael W. Lamach: Data centers would be huge. That's the places where we are today. And I don't know of any state really that's blocked for that essential activity. So even the most stringent states, obviously health care and such, we're in there servicing.

Answer – Zachary A. Nagle: Okay. Jason do we have another question? I don't know if anyone can hear us, but that will wrap up our call for today. We'll be around for any questions that you may have. Please feel free to reach out to myself or to Shane, and we look forward to speaking with you soon. Thank you.