Trane Technologies
Q2 2026 Earnings Conference Call
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Operator: Welcome to the Trane Technologies Q2 2026 Earnings Conference Call. My name is Lisa, and I will be your operator for the call. The call will begin in a few moments with the speaker remarks and the Q&A session. (Operator Instructions)

I will now turn the call over to Zac Nagle, Vice President of Investor Relations. Please go ahead, sir.

Zac Nagle: Good morning, and thank you for joining us for Trane Technologies Q2 2026 Earnings Conference Call. You can access our webcast and slide presentation at tranetechnologies.com, a replay will be archived there as well.

Today's discussion includes forward-looking statements. Key risk factors are listed in our SEC filings. We also use non-GAAP measures. Explanations and reconciliations are in our press release and presentation appendix.

Joining me are David Regnery, Chair and CEO; Chris Kuehn, Executive Vice President and CFO, and joining us for Q&A is Donald Simmons, Executive Vice President and Chief Operating Officer.

With that, I'll turn the call over to Dave. Dave?

David Regnery: Thanks, Zac, and good morning, everyone. Please turn to Slide 3. I will start with a few thoughts on how our focused strategy continues to propel our performance.

Elevated energy prices are driving companies to assess their operations, and customers are choosing Trane Technologies to enhance performance, save energy and reduce operating costs.

Our smart systems, integrated controls and agentic AI allow buildings to predict, act and optimize in real time for industry-leading efficiency and resiliency. Our strategy is built on a strong foundation, our robust business operating system, a powerful cash flow engine and an uplifting engaging culture. This formula positions us to deliver differentiated long-term value to our people, our customers, our shareholders and our communities.

Please turn to Slide 4. Q2 was another strong quarter. Enterprise organic bookings were up 37%, driving record backlog of $12.1 billion, up 70% year-over-year. Organic revenue grew 9%, led by Americas Commercial HVAC and services and residential, and adjusted EPS increased 11%.

Our commercial HVAC businesses delivered outstanding performance, particularly in the Americas, where bookings reached an all-time high up 50% year-over-year. Applied bookings were up 130%, marking our fourth consecutive quarter of growth above 100%. On a two-year stack, applied bookings are up more than 4x.

We are fueling robust growth for 2026 and beyond. Our exceptional bookings, record backlog and healthy pipeline provide strong visibility to accelerating revenue in the second half. Our historic backlog also lays a strong foundation for continued market outperformance in the future with approximately $6 billion slated for 2027 and beyond.

Services, which represents about one-third of enterprise revenue, continue to be a consistent, durable growth driver with a low-teens compound annual growth rate since 2020.

Residential was strong in the quarter, and we expect second half tailwinds driven by market fundamentals and easier comparisons.

Americas transport market fundamentals continue to improve, supporting the outlook for late 2026 and 2027 recovery.

Operational excellence remains central to how we run the business and underpins our success. We expect continued strong execution as we move through the year. All in, we are raising our full year revenue and EPS guidance, which Chris will cover shortly.

Please turn to Slide 5. Second quarter results were strong, led by standout performance in Americas. Commercial HVAC delivered exceptional bookings, up 50%, and organic revenue up low teens. Our Residential business exceeded our expectations for the quarter, with bookings up high 20s and organic revenue up low teens.

In EMEA, performance was consistent with our outlook. It's worth highlighting the underlying strength in commercial HVAC, where excluding the impact of the Middle East conflict, bookings were up mid-20s and revenues were up mid-single digits. Our teams in Asia Pacific also delivered strong results with bookings up 31% and organic revenue up 10%.

Now I'd like to turn the call over to Chris. Chris?

Christopher Kuehn: Thanks, Dave. Please turn to Slide 6. Dave covered the key drivers, so I will be brief.

Enterprise organic revenue grew 9%, supported by robust equipment and services growth. Adjusted EPS increased 11%, underscoring the effectiveness of our business operating system in driving operational excellence throughout the P&L.

Please turn to Slide 7. Our performance this quarter reflects strong execution and strategic reinvestment across the portfolio. Margins in the Americas and Asia remain healthy and reflect increased investments in capacity, innovation and channel expansion to support robust demand.

In EMEA, margins were impacted by the conflict in the Middle East. As the regional outlook became clearer during the quarter, we acted to align our cost structure for improved profitability in the second half.

With that, I'll turn the call back over to Dave. Dave?

David Regnery: Thanks, Chris. Please turn to Slide 8.

Our 2026 outlook has strengthened, reflecting accelerating growth in the second half, driven by continued strong execution. In commercial HVAC, momentum is robust, driven by exceptional bookings, a robust pipeline and historic backlog. We are certainly seeing strength in data centers, but also broad-based growth across the majority of our key verticals -- as a result, we are raising our full year outlook.

In Residential, we are also raising our full year outlook to reflect our strong year-to-date performance while maintaining a prudent outlook for modest growth in the second half.

The slide outlines second half headwinds in EMEA stemming from the Middle East conflict. Importantly, our raised guidance fully absorbs these challenges, reflecting the strength of our portfolio.

Our outlook for the rest of the business is largely unchanged. We've provided additional details on the slide for your reference.

With that, I will turn the call back over to Chris. Chris?

Christopher Kuehn: Thanks, Dave. Please turn to Slide 9.

For the full year, we are again raising our guidance. This reflects the market dynamics and investment priorities we've discussed and consistent strong execution of our value creation flywheel.

We are increasing our full year organic revenue growth outlook to approximately 9% and our adjusted EPS guidance to a range of $15.20 to $15.30. For the third quarter, we expect organic revenue growth of approximately 10% and with adjusted EPS of approximately $4.70.

Please turn to Slide 10. This slide provides a clear view of the acceleration we expect in the second half of the year. The step-up in performance is supported by robust backlog and gives us strong momentum heading into 2027. For additional details, please refer to Slide 17 of the appendix.

Please turn to Slide 11. We remain committed to a balanced capital allocation strategy focused on deploying excess cash to maximize shareholder returns. First, we strengthened our core business through relentless reinvestment. Second, we maintain a strong balance sheet to ensure optionality as markets evolve. Third, we expect to deploy 100% of excess cash over time. Our approach includes strategic M&A to enhance long-term returns and share repurchases when the stock trades below our calculated intrinsic value.

Please turn to Slide 12. We remain on track with our balanced capital allocation strategy with a target deployment of $2.8 billion to $3.3 billion for the year. A key component of this strategy is our commitment to shareholder returns.

Earlier in the year, we increased our dividend by 12% to $4.20 per share annualized. In addition to dividends, we have repurchased approximately $840 million of shares year-to-date with $3.8 billion remaining on our current share repurchase authorization.

We continue to pursue disciplined M&A and are strategically investing in capacity to support future growth with expected CapEx of 2% to 3% of revenue in 2026. Our strong balance sheet and free cash flow continue to provide us with significant optionality.

With that, I'll turn the call back over to Dave. Dave?

David Regnery: Please turn to Slide 14.

Following a prolonged downturn, we see the Americas transport market improving in late 2026 leading into a multiyear upcycle. Our internal outlook is directionally aligned with ACT, but assumes a more gradual slope of recovery. This reflects a more realistic pace for trailer OEMs to ramp capacity, a dynamic that has historically extended the duration of the upcycle.

Having managed the downcycle effectively, while outperforming the markets. We look forward to this business transitioning from a headwind to a healthy growth contributor for our portfolio.

Please turn to Slide 15. In closing, our strategy is aligned to powerful megatrends that are intensifying the need for our sustainable solutions and services. Customers choose Trane Technologies for our leading innovation, strong execution and the expertise of our team around the world.

With our clear strategy, exceptional bookings strength and record backlog, we are confident in raising our full-year guide and are well positioned to continue delivering differentiated shareholder value in 2026 and beyond.

And now we'd be happy to take your questions. Operator?

Operator: (Operator Instructions). And your first question comes from Scott Davis, Melius Research.

Scott Davis: I'm great. It's been a very busy quarter, which is, I guess, always is, but it feels extra busy.

Anyways, a lot of things here, and I do appreciate your shortened prepared remarks. I appreciate that also.

David Regnery: I thought I might get that comment from you, Scott, but (inaudible).

Scott Davis: Free up some time for Q&A. But I have to ask, I mean, with the bookings you have in resi, did inventories get too low, did we overcorrect and now we need to correct up the other direction? Is that kind of what's going on here?

David Regnery: I don't think I -- we do -- we track the IWD, Independent Wholesale Distributors inventory pretty closely. I think we were in a good spot.

Look, that was -- if you remember correctly from the fourth quarter, that's kind of where we -- unfortunately, we had to take 30% of our production days out of the cycle to get the inventory where it needed to be. We came into the year with the right level. And the good news is it's still at the right level, which is reassuring for us in the back half of the year.

Christopher Kuehn: And I would add, Scott. I mean, year-to-date sell-in is really approximately equal to sell-through. And to Dave's point, inventory is at a good spot at the end of the quarter.

Scott Davis: Okay. Fair enough. And then the price versus cost and kind of you guys are delivering a fair amount of stuff and taking big orders in and the scaling issues, et cetera. But did the cost issues kind of mitigate over time and thinking in terms of scaling in particular on new capacity, but would we -- I guess a better way to ask the question is should we expect a little bit of improvement in incremental margins kind of going forward?

Christopher Kuehn: Yes. That's how we got the guide slated for this year, margins are stronger in the second half and comps do matter. In the second quarter last year, we had organic leverage up around 40%. So you're right, it does get better in the second half.

I mean, price versus all inflation. It was a headwind in the second quarter as we thought. We're having our guide, it will be a bit of a headwind in the second half of the year as well. It does sequentially get better from Q2 to Q3 than to Q4. But we're just leveraging all parts of our business operating system right now to take in all these cost inputs, make sure we can offset where we can with supply chain, where can we drive productivity, and then ultimately, lead with pricing or follow up with pricing as needed.

David Regnery: I would also tell you, Scott, that we invested pretty heavy in the second quarter, a couple of capacity expansions that we did. We're deploying our operating system in Stellar. So we pulled some investments forward there. But look, these are all good long-term investments for our future.

Operator: Next up is Andy Kaplowitz from Citigroup.

Andrew Kaplowitz: So David, Chris, maybe you could give a little more color into your commercial HVAC pipeline and the strong orders you've been booking. Does the pipeline continue to refill even as your bookings and backlog have been accelerating here?

And obviously, you just talked about Stellar, you've been beefing up your sort of portfolio with these recent acquisitions. So how are they doing in terms of helping your share? And maybe you can talk about the strength of other verticals besides data centers, which we know are strong.

David Regnery: A big question there. But yes, look, as far as orders go in commercial HVAC in the America is obviously very strong, 50% growth.

The pipeline, Andy, I told -- I think I told you on an earnings call, probably two or three quarters ago, I said I have a -- we have a pipeline that I've never seen as strong as it is. And I sit here today and I look at our pipeline, and it's still really, really strong, which is just great for the future.

The only thing I would add there is the pipeline in Europe has really started to increase. And again, in Europe, we had -- think of it as commercial HVAC, excluding the Middle East, we had orders up over 20%, but we also have a very, very strong pipeline there.

On your question on verticals, look, obviously, with 50% growth in the Americas, I think everyone is aware, we track 14 different verticals. They were all very strong. They were all up in fact, they were all up -- all of them up over 20%. But it's probably more constructive to look year-to-date, and year-to-date, we had growth in 11 of 14 verticals from an order standpoint. And most of those 11 were double-digit growth.

So Andy, as we've spoken before, we're very strong in the data center vertical. We've been very strong for a long time and will be very strong in the future. But the growth that we're seeing right now is very broad-based, which plays to our strength with the strength of our leading portfolio. This is core to Trane Technologies and it was a great second quarter, but really excited about the future because we have so many opportunities in front of us.

Donald Simmons: And I'll add something. This is Donny Simmons, the Chief Operating Officer. I've been with the company for 25 years. Glad to meet everybody that I haven't met before.

One thing I'll add to Dave's comments there is that in the second quarter, we had four orders that were over $100 million in the business and one of which was in Stellar, which was an excellent start to that acquisition.

Andrew Kaplowitz: Very helpful. And then, Chris, I'll just ask you a small question here, like on the Middle East impact. You already talked about it. But maybe you could elaborate on the cost actions you took there and the ability to sort of inflect even if the Middle East is still a bit weak in terms of EMEA margins in the second half.

Christopher Kuehn: Yes. Thanks, Andy. I mean just to step back, the Middle East is less than 3% of our total enterprise revenue. But when you look at the EMEA segment, it represents almost about 15% of that segment. So that's why we wanted to make sure we called out that excluding the Middle East, the segment had strong bookings in the quarter, up mid-teens and then revenues were positive, up low single digits.

But just given the ongoing conflict and the performance in the second quarter, we did take some cost actions at the end of June. This would include looking at rightsizing for positions and also for infrastructure. That's behind us at this point. Confident that the deleverage was above gross margins in the second quarter. After those cost actions, we do expect deleverage to be within gross margins into the second half of the year.

We do expect the revenues, we're anticipating to be down about 30%. It was down about 30% in the second quarter. We've got that in our guide for the second half as well, but it'd been down about 30%.

And again, we're just -- we're thankful for the team that's there in terms of they're executing under difficult conditions and we've got this baked into our guide at this point.

Operator: Next up is Chris Snyder from Morgan Stanley.

Christopher Snyder: I wanted to ask about backlog. So you guys -- you exited the quarter with over $12 billion of backlog. You started the year at less than $8 billion. So added $4 billion, up 50% in six months.

I guess the question is, has there been any change in the conversion of backlog versus a year or two ago, just backlog is built. I imagine every -- you guys are mixing to data center, which may be a slower conversion. Just kind of any thoughts on if that's changing versus a year or two ago?

David Regnery: Good question, Chris. Hope all is well.

Look, our backlog is up significantly as we're now through the second quarter. 90% of the backlog is in commercial HVAC and -- which is probably similar to what we said in the past.

On the conversion, if you look at our revenue growth in the second quarter for Applied, it was up over 40%. So you can see the backlog is starting to flow through. And if you look at the back half of the year, based on our current guide, we're projecting that 40% to carry forward to the back half of the year.

So very strong backlog, gives us a lot of visibility, not only into 2026, but into 2027. We have approximately $6 billion of the backlog is for 2027 and beyond. So it's going to be not only a very strong second half for us, but we're going to carry a lot of momentum into 2027.

Christopher Kuehn: Yes, Chris, I would add. I mean backlog remains now almost 95% for commercial HVAC, and it's up year-over-year. The backlog in our commercial HVAC business is up year-over-year about 90%, so very strong.

Christopher Snyder: Wow, yes, it's kind of getting normalized to hearing these massive growth numbers, but it’s pretty wild. Maybe a bigger picture question to follow up with.

There’s a lot of noise and headlines in the market about cooling demand into data center, and I imagine there are changes to the architecture just given how fast that data center market moves. So Dave, I’d really be just interested in your view on this.

You guys are always typically ahead of the curve on where things are going. Obviously have an incredibly broad portfolio to kind of cover any kind of maybe changes that are out there. Just would be interested in your perspective on a lot of that news. Thank you.

David Regnery: Yes. Thanks for the question, Chris.

Look as you said this -- the innovation in this particular vertical moves very fast. And obviously, we're working direct with hyperscalers, colos or other influencers. And we're constantly looking at reference designs or data centers of the future.

I guess if I had to sum up what I think the innovation of tomorrow will be there. Think of chillers as getting smarter. And in our world, when you think about the thermal management system, whether that desired leaving water temperature needs to be 31 C or whether it needs to be 45 C, it doesn't matter to us. With our portfolio, we're going to optimize to ensure that, that data center is getting the right mix of water temperatures so that it can operate in the most efficient way possible.

And when I say chillers are getting smarter, think of it as building in control systems so that if you want to run in a free cooling mode, meaning that you could use the ambient air to do the cooling, that's great. If you need to do some vapor compression or running your compressor to tweak that water temperature, we're able to do that.

So it's really -- it's fun, okay? I mean, I sit through the -- with our engineers, and they bring up these concepts. It's just -- it's moving fast, but I would tell you, we're on top of it. We see where this is going at least right now, and my bet is that will change in the future. But right now, we have some great solutions that -- some of which we're selling, some of which are in the pipeline. But we're working with all the influencers to make sure that they know what's possible. And they challenge us and we challenge them, which is a great way to come up with creative solutions.

Donald Simmons: Yes, Dave, just -- I'll add a little bit there.

So I think about one of the ways that we win in this market is the design days that we do. And in the second quarter, we had --

Operator: Ladies and gentlemen, please stand by. We have lost our main speaker line. Once again, everyone, please remain on the line while we reconnect our speaker line.

Once again, everyone, we do expect our speakers back on shortly. Please continue to stand by.

Once again, ladies and gentlemen, our speaker will be joining momentarily. Please continue to stand by.

David Regnery: All right. Chris, sorry about that. We're going to do this the old-fashioned way on cell phones. So we sound a little bit scratchy, that might be it.

So Donny, go ahead, you were adding a little color.

Donald Simmons: Yes. Sorry about that, Chris. What I was saying is that when we think about this market and the focus that we have overall, we look at the thermal management system for the customer, we have design days. So in the second quarter, we had multiple design days with our customers with these critical customers. And we're looking at the full portfolio of the thermal management system.

So we don't just talk about chillers. We're talking about the chilled water requirements that they have that would be from chillers as well as air handlers as well as CDUs and how does all of that work together to meet the requirements of the customer. And that's where we really focus on the innovation and what the requirements are and how we're looking at the next wave of new products that we're developing for our customers to meet those requirements.

David Regnery: It's a great vertical. We're strong guys, we're going to be strong well into the future.

Operator: Our next question will come from Amit Mehrotra from UBS Financial.

Amit Mehrotra: I guess I just wanted to come back to backlog. Backlog, if I look at backlog today, it's more or less 50% of this year's revenue and that backlog is sort of mostly attributable to 15% to 20% of your revenues, which is applied equipment. So just given there's no material elongation of the backlog, I guess it kind of begs the question, at what point do you start turning away orders because of any capacity constraints. If you can just talk about that, I appreciate it.

David Regnery: Yes. I think, look -- I'll start. Look, we have about $6 billion of the backlog, that's for 2027, as I said earlier. So that's going to give us a lot of momentum going into next year.

We're not turning away orders, okay? We kind of -- I think I mentioned probably two quarters ago, we've expanded our applied capacity 4x over the last three years. That expansion continues to happen.

So we have several -- first of all, we deploy our lean principles. So we're always looking to do more with what we have. But with that said, we also have brick-and-mortar investments that we're making. We talked about Stellar already. We also have in Grand Rapids, we're making some investments. So look, that's going to continue.

We're in front of that. So I feel like we're in a good spot there from a, do we have enough capacity for the orders that are out there. And bring on -- if you have any orders and then just bring them out. Have them call me up.

Amit Mehrotra: I guess it's my cheeky way of asking. It wasn't that long ago, we were asking you $5 billion was peak. And here we are approaching $8 billion. And is my cheeky way of asking, are we at peak orders or not. I think you mentioned --

Donald Simmons: Well, Amit, I can remember when it was $2 billion, okay? And I was getting asked about how are you going to maintain that? So we've come a long way.

But look, the good news is that the pipeline of orders is so strong, and that's what gets me excited. And it's not just in the Americas, okay? We're seeing a lot of pipeline as well, as I said earlier, in Europe, which we haven't seen in a while. I mean, Europe has performed very well for us. But we haven't seen -- we almost came to an inflection point with the pipeline there, which is we're really looking forward to some strong orders in EMEA.

Christopher Kuehn: Yes. Amit, I'd add some of these investments are captured in CapEx. Some of these investments are just flowing through the P&L as you think about ramping up production and bringing our business operating system to line. So that's one of the impacts on leverage here in the second quarter, it may impact leverage in the very near term.

But for us, these are great medium to long-term investments to make for the company to make sure that you've got the revenue capability. And to Dave's first point, a, we're not going to get behind; and b, we're not turning away any orders.

Amit Mehrotra: Okay. Chris, maybe if I could just ask a follow-up. We're now closer to 2027 than we are to the start of 2026. So I'd just be curious, I mean, you're -- we're ending this year kind of second half growth of 11.5%, first half growth this year, 6.5%. Is that exit rate sort of the right starting point to build off of in '27? I know you're probably not going to answer that question, but I want to ask it anyways.

And just related to that just related to that, are we not only you guys have the capacity, but we've had a couple of examples where the supply chain have not met the expectation? And just talk about how comfortable you are on that almost doubling of organic growth one-half to two-half, where your supply chain can come along with you?

Christopher Kuehn: Yes. I'll start with the first part of your question, and then we can kind of address the supply chain.

But look, there's a lot of things to be excited about as we go into the back half of this year, and we always thought our exit rates at the end of '26 would be stronger than the exit rates we had at the end of '25. We've got significant growth in our applied business. Bookings remain strong, and we have, as Dave said, over $6 billion of backlog for next year already here at the end of June.

So it's given us a lot of confidence for this year's guide, more visibility in the next year than we normally had. We are seeing tailwinds in both our residential and our Thermo King businesses. That's something to be excited about as well.

Dave mentioned Europe commercial HVAC has been seeing strong orders. And then our services business, again, about a third of the enterprise revenues growing double digits.

So we know not everything is going to go perfect, but we like this setup as we're going in the second half of the year. And let's get a few more quarters in before we dial in 2027, but we're going to like the exit rates.

David Regnery: Yes. And on the supply chain capacity, look, we always are working with our supply chain partners on deliveries. It's what we do every day, welcome to manufacturing.

But look, as volumes continue to expand, we are asking more from our supply partners. And so are we seeing constraints? Yes, but we always do. Are we seeing a bit more than normal? Maybe a bit more than normal, but nothing that our team can't manage. And we do a great job of managing with our supply partners.

And I used the word partners because they really are partners. And many times, including myself, will meet with the leaders of these companies to make sure that we're in lockstep on what we see coming and how we're going to leverage them and how they could help us.

So I don't know, maybe it's useful, Donny, if you could just give some examples of how we work with our supply partners.

Donald Simmons: Absolutely. So actually, just this morning, I was on the call with the CEO of one of our great partners talking about what our plans are and what they're doing to ramp up capacity.

What I would say is that we lean heavily into our business operating system. And much of that has been developed over the last couple of decades, but a lot of that was even developed even further in 2021, 2022 during the supply chain crisis post COVID. I lived through that. That was a lot different than now. We're not in the same scenario as we were then.

We're looking at a three-year plan and think about that in terms of multiple levels. So we look at here's what our three-year plan is. We communicate that with our suppliers. We look at what's the max capacity of our current factory footprint. We communicate that with our suppliers. And we also look at what's the unconstrained demand and what are our plans and we share that with our suppliers.

In many cases, we'll see some of our lean resources to work with our suppliers on how to improve their own processes. We also work with them in their supply chain and making sure that they're able to secure components to make sure that they're able to meet the demand that we have as well.

So it's a very robust process within our business operating system.

David Regnery: Yes. Thanks, Donny. I mean, as Donny said, we have a very robust process around this, so our team is managing the situation great.

Operator: We'll take the next question from Andrew Obin, Bank of America.

Andrew Obin: Just a broader question, I guess, maybe for Dave and Donny. How do you think about running companies structurally in sort of this high-growth inflationary environment because it doesn't seem inflation is going to go away. Any changes to operating model? Do you -- how do you negotiate with customers? How do you lock in capacity with hyperscalers? Was this in this inflationary environment? Any color will be very helpful.

David Regnery: Yes, Andrew, I mean, it's a great question. I mean, look, our operating system -- we have an operating system, obviously, around how we deal with inflation, okay, which is kind of what you're referring to. And we have an operating system around how we conduct pricing, okay, in our markets. So you really have to -- I don't want to go into too much detail, but there's a lot of detail between all of those, okay?

On the inflation side, if we see inflation, which obviously we all are seeing right now, we're working with our suppliers, we're working on the resiliency of our suppliers. We're working on our own internal productivity, and if we're not able to offset that, then we'll do pricing.

On the pricing side, we're very strategic on the pricing. We have a whole operating system built out around that to understand that, a, we have to be very competitive, but we also want to always be fair to our customer because, again, we want customers for life.

So it's a multipronged attack that we leverage, but it really comes down to our operating system, right? It's not like we recreate it every time. It's a very powerful tool that we have.

Donald Simmons: Yes, I'll add to that, Dave. So I think about with our customers, many times, we'll have long-term capacity agreements in place with those customers. So we understand what the volume is going to be. That's a bit different than it was in the past.

And we also give those -- that same visibility and those commitments to our suppliers. So that helps us manage.

The other one is, and Dave touched on it productivity, I think it's a really important point because it's not all about pricing. It's also about how we drive productivity.

When we launch a new product, the day after we launch that product, we're looking for how do we remove cost out of that product. That could be through in-sourcing components, it could be through redesign, it could be multiple different levels.

So we always have a pipeline of productivity to help offset that inflation as well. So that's just part of our business operating system.

Andrew Obin: And maybe a follow-up question. I think in February, you launched a battery energy storage systems rental offering. And it seems that internally, you guys are focused on improving off-grid reliability, and this seems to -- there is a part for you to play sort of improving grid resiliency and shaving peak capacity.

Could you just expand on it? What kind of conversations do you have with customers on this concept? And how fast do you think adoption could be over the next 12 to 24 months?

David Regnery: Yes. Sure, Andrew. Look, this is where we're talking about smart, resilient buildings, right? And this plays into our acquisition that we did just about 1.5 years ago now with BrainBox.

But think of a building, getting smarter, and that's with our Agentic controls and resiliency. And in the future, we believe that buildings will have alternatives to what type of energy they're going to use at any one time, whether that be electricity or whether that be a fossil fuel, and/or storage. And that's where the battery comes in.

So we're still early days, but obviously, as we as we have these conversations with our customers, very excited, a, about Brainbox because that's a great starting point, but more about the amount that they're able to reduce that [they] waste.

And remember, most buildings today conservatively, conservatively waste about 30% of the energy they pay for. And in tomorrow's world, they're going to get smarter, and we're going to help them build the resiliency into how they operate. It's a massive opportunity for us.

Operator: Your next question is from Noah Kaye, Oppenheimer.

Noah Kaye: Wanted to ask about the increased business reinvestment and the CapEx raise. You said some of it is for Stellar and tied to the modular demand growth there. But just what are the benefits that are coming from that reinvestment? And then is the higher CapEx primarily supporting what's in backlog? Or is this for longer-dated growth expectations?

Christopher Kuehn: Yes. No, I'll start. I mean we've guided CapEx to 2% to 3% of revenue for the year. I'd put it still very much in a CapEx-light model. To the earlier points, we've been investing in capacity for every year, but certainly for the last three to four years, we've added 4x amount of capacity in our applied business.

So when I think about that, this is -- part of it is focused on new acquisitions and how do we make sure that we can scale them for even stronger growth. Taking these strong acquisitions, tying them into a direct sales force and to the opportunities that we see globally. That's a nice investment to make. So it is a constant focus of us. Not a game that I don't think we've ever found ourselves behind in.

David Regnery: And no, it also gives us a lot of confidence as we make these capacity expansions to Amit's question, about are we turning away orders, absolutely not. And that's because we're very confident in our four-wall capacity.

Christopher Kuehn: Yes. I mean outside of capacity, there's innovation investments that we're making all the time. We've explained some of them may be in the data center vertical. Given the speed of that innovation cycle and the quickness of that innovation cycle, but that really can spill over, and it has, into other verticals as well.

And then after that, it's operational excellence. It's bringing as Donny mentioned, cost out for products, it's leaning out production and maybe some insights not just in our facilities, but in our supplier partner facilities too.

Noah Kaye: Very helpful. And then maybe just to put a finer point on margin trajectory. I think, although correct me if I'm wrong, that 3Q is implied to be back to year-over-year margin expansion. Maybe you can talk directionally about where we should see margin expansion across the segments because obviously, with EMEA, there's a tough comp there with Middle East continuing. So just trying to understand how we should think about it across the segments.

Christopher Kuehn: Yes. No, I'd say you're right on the guidance that we put out that we have a lot of confidence in, we would expect margin expansion in the third quarter. It's probably in that 50-ish basis point kind of range.

And then it accelerates into the fourth quarter, which should be -- we'd be targeting over 1 point of margin expansion. And driving the margin expansion on the full year.

A lot of that will be led with the Americas just given the relative size of the business. I would expect EMEA will be under pressure for margins as we go into the second half, just given we've taken, again, Middle East is around 15% relative to that region to that segment. We've taken out about 30% of the revenue now in our guide. So I expect that to be a bit of a headwind for that segment in the second half.

And then for Asia, let's see. I mean it's a little bit of a loss, small numbers on margins for Asia when you look at percentages, but very encouraged with the order rates that we've seen in the rest of Asia and where we're seeing the growth there.

So we do have, I think, about leverage overall, with the M&A that we've done this year, we've again reaffirmed on that guidance that there's about a 700 basis point delta between reported leverage, which will be lower than organic, and a lot of that is from the M&A and the investments we're making in year one.

David Regnery: Yes. And I would just add that, look, as the CEO, I'm focused on the long term -- so any -- I'm not necessarily concerned about leverage in any quarter or really in any half of the year, okay? It's more about the long-term vision that we have as a company, we just see tremendous opportunities on the growth side of things. We just want to make sure we're ready.

So we're always going to be making those long-term investments. And by the way, it's proven out to be very, very beneficial for us [too]. And I know you've tracked us for a while, so I'm sure you're a believer in that.

Noah Kaye: For sure. And thanks for the help dialing in the models as well.

Operator: Jeff Hammond from KeyBanc Capital Markets has the next question.

Jeffrey Hammond: So just back on kind of the chiller and data center question. Just can you talk about what -- how your customers are maybe ordering differently between liquid and air cooled chillers and kind of -- some of the new products that you've been introducing I think, Dave, you talked about Grand Rapids expansion and new -- some new air cooled products as well. So just want to understand the shift there, if any?

David Regnery: Well, I mean, I think, as Donny kind of alluded to, many of our hyperscalers now have -- whether it be a master purchase agreement or a long-term capacity commitment with us. So we're gaining a lot of visibility to what they need, okay?

As far as the technology goes, we certainly see a mix towards the air cooled side, okay? These are air cooled for sure, but think of it as less evaporative cooling, okay? Most systems that we're designing now, not all, but I would say that it's sort of weighted towards closed-loop systems.

And unfortunately, if you read the press, you'll see that there's a lot of conversations about how data centers waste water. And the reality of it is, is that statement, to be honest, that's not necessarily true in the majority of the cases. So that's certainly a trend that we're seeing.

There's other trends that are out there, too, that I'm sure you've heard about like whether we're going to be going to direct current versus alternating current, and rest assured, we're well aware of that, and we'll -- we help -- we're helping many of our hyperscalers and our big colos design those systems.

Anything you want to add, Donny?

Donald Simmons: Yes, I think you hit on it very well. I do think that the overall market has trended more towards air-cooled historically, like if you go back five years ago, you would see water-cooled when a customer was expecting to have a 40-year data center and air-cooled when they were having a 20-year data center. And so that shift has changed given the capacity requirements and the increase.

Overall, many times, customers will choose water-cooled when it's -- when they want the absolute best possible efficiency. But even then with air-cooled technology today, we can get similar, if not better efficiencies. So it really just depends on what the design is for the customer, and that's what we focus on meeting their requirements, making sure that we deliver what they need.

David Regnery: That's what -- those are the conversations we would have during these design days that we have with many of the hypers.

Jeffrey Hammond: Okay, great. And then just Stellar came in lighter, I guess, North America acquisition revenue came in light. I just want to better understand the cadence of this $500 million of Stellar revenue into 26 as you ramp there.

David Regnery: Yes. I don't think a lot has changed with Stellar. Look, we -- just to refresh everyone's memory, we had -- think of the backlog we brought in when we had the acquisition of about $1 billion. We said about half of that would ship this year, about $500 million. We're on track to that.

Probably the only thing that's changed with Stellar is as we're implementing our operating system, we pulled some investments forward. And I think I told you all at the end of last quarter that we thought Stellar would be modestly accretive for the year. I think you should look at -- and what we have modeled into our guide is Stellar being flat for the year from an EPS standpoint.

But again, it's pulling in these investments. We need to be able to make sure that we have the operating system deployed there for future growth.

And the good news, as Donny said, one of our large orders this quarter was for Stellar. So we're making a lot of progress there, and I'm excited about the future of Stellar. It's -- and you've heard me say this before, it's modular chiller plants. It's -- today, it's basically 100% focused on data centers, but we know that that is a product that is very applicable to other verticals as well.

Donald Simmons: And I would just add, as we said last quarter, we expect the Stellar business to be $500 million in revenue this year, and nothing has changed there. So we -- no change in revenue.

Operator: The next question comes from Varun Govindaraj from Bernstein.

Varun Govindaraj: So quick question. On -- for the back half of the year, clearly, you're expecting a ramp, how confident are you in customer ability to take delivery, specifically for data center products? I'm asking because there’s that narrative out there the projects are getting delayed, power is taking longer to connect, and it's obviously harder to test and commission a chiller when you don't have power. So any commentary you have there would be helpful.

Christopher Kuehn: Yeah, Varun, look, we have a lot of confidence in the backlog. And as we think about our guide, we always assume some level of leakage, breakage in the guide, right? We know not everything goes perfectly. We do a great job with our suppliers, but we're also making sure that we've got a little bit of breakage in there.

So could there be some things in shift? It is just part of site construction and otherwise, but I'd say that we're confident in our guide.

David Regnery: Yes. I mean you're always going to see some job sites move, okay? And we certainly see some of that in the data center, both positive and negative, right? We also have other customers that are saying, "Hey, can you ship early."

So look, nothing that's alarming right now, but it's a good question.

Varun Govindaraj: No, appreciate it. And separately, on the Thermo King side, expecting a recovery in the back half of the year, the ACT numbers look positive. What other signals are you seeing that sort of give you confidence independently of the forecasts that are coming in?

David Regnery: Yes. Look, we think that Thermo King is going to be transitioning into more of a growth engine for us to come in the back half of the year.

Look, rejection rates have remained high for several months. That's a key indicator. Spot-to-contract spread is trending positively for several months, and utilization rates have trended positive for the last 10 months. So these are all good signs for our Thermo King business.

And I just look forward to Thermo King becoming more of a growth company as we are as Trane Technologies. And I'm very confident that we're going to start to see that in the back half of the year, and that should carry momentum through 2027.

And this is a business too that even though we've had a trough for an extended period of time here, we have not stopped investing in this business. So we have a lot of great products, and we're willing -- we're excited to delight our customers.

Operator: The next question is from Alexander Virgo, Evercore ISI.

Alexander Virgo: I wondered if you could talk just a little bit about the impact from business reinvestments in the Americas. I wonder if you can maybe give us a sense of the weighting of those three points. And whether or not it's something we need to think about as we think about the first half of next year as well.

Christopher Kuehn: Yes, Alexander, this is Chris. I'll start.

I mean weighting, it's probably in the order that we provided as we think about capacity, innovation and operational excellence. But I wouldn't say materially different. These are things that we are investing in though all the time.

And in fact, back in May, at least twice a year, we have innovation reviews and we go business by business. We've had to cap them at 10 ideas and/or launches just because we'll go over time. And each and every year, we think about the investment cycle that we have and I would just tell you the pipeline remains very robust and our bias is always to accelerate on the investments.

Within the confines of let's drive leverage over the long term, 25% plus. But look, we've got accelerated orders, accelerated backlog, and we're just going to keep investing to make sure that we're staying ahead as we have so far.

David Regnery: Yes. I think it's a good question. But look, don't get hung up on any one quarter. We've been saying for a while, our target is 25% plus. We may have a quarter like the second quarter, we were below that, but that's okay, right? This is all about long-term growth that we're creating.

Alexander Virgo: No, I appreciate that. That's kind of why I was thinking about the next 12 months, I guess, and thinking -- I appreciate your -- you do this all the time. And therefore, if you're calling it out now is obviously a little bit more, which I get because of the pipeline and the backlog. But that's kind of why I was thinking about it on a 12-month view rather than the quarter per se.

David Regnery: Yes. No, that's good question.

Operator: We'll take the next question from Joe Ritchie, Goldman Sachs.

Joseph Ritchie: Yes, doing great things. So really good results. I wanted to just focus on resi for a second, the low teens growth this quarter. Is there any way to bifurcate how the replacement market did versus resi new construction? And the reason I'm asking is you had a peer report yesterday, who was calling for pretty tough pricing in that market and walking away from some business. So I was wondering if you can maybe shed some light on the resi new construction market.

David Regnery: Yes. Look, our position there really hasn't changed. I think you know, we're heavily focused on the replacement, not undue construction. That said, we do have, I don't know, maybe it's we'll say in the teens as a percentage of the business is residential new construction.

But we're -- think of it, when we talk about residential new construction, we're usually talking about the think of the smaller builders that are building custom homes. And -- but we're doing -- we're -- look, it was the resi team, they had a very strong second quarter, okay? Some of that had to do with all the debacles that happened last year.

But I'd tell you, I give that team a lot of credit. They've executed very well. And I'm just proud of what they've been able to do. I think there's -- we've -- year-to-date, our resi business from a from a dollar basis is up mid-single digits, and we're projecting that to carry forward for the rest of the year.

And if you remember, when we came into the year, we thought that residential could be even down a bit this year. And then at the end of the first quarter, we revised it to flat. Now we're very confident with our guide that this will be a mid-single-digit growth number for us in 2026, and we'll see how that carries forward for positive momentum into 2027.

Joseph Ritchie: Yes. Great. No, it's great to see a rebound there.

And then just a quick question, a follow-up on just data centers. Can you just level set for us at this point how the CDU business is doing? I think you guys started shipping earlier this year. What does the pipeline look like? Maybe just in terms of like how much of your backlog it is today. I'm just curious like how that business is trending.

David Regnery: Yes, I probably won't go into that level of detail, but I would tell you that, look, it's -- we're in the CDU business. Business is performing. The liquid stack acquisition is exceeding our expectations and the pipeline is strong.

Operator: Your next question is from Jeff Sprague, Vertical Research Partners.

David Regnery: Jeff, how are you? Is it hot in Connecticut?

Jeffrey Sprague: Dave, we don't need any AC up here. It's cold and wet. So yes. Not for fun.

David Regnery: I was up in New York -- I was up in New York a few weeks ago and it was boiling. So anyways, must have cooled off.

Jeffrey Sprague: A few weeks ago, it was unbearable. Yes. But now we need a rain here today all week actually. But I'm doing well.

Just a couple of quick follow-ups. I know we covered a lot of ground.

I just wanted to come back to Europe and even maybe Asia. In Europe, ex Middle East, there's a pickup that you're starting to see, is that primarily data center? That market kind of content coming around, trying to catch up? Or is there a level of breadth and the activity you see there?

And similar on Asia, we've heard from a number of companies, even beyond HVAC, this earnings season that non-China Asia is looking better. Maybe you could just provide a little bit more color what you're seeing there.

David Regnery: Yes. As far as Europe goes, it's both, okay. We're certainly seeing data centers there. We certainly are seeing core vertical growth there as well.

One thing I would say on the pipeline in Europe, as we're looking -- as we talk about data centers, they're getting bigger, okay, which is -- that's a good sign, right? They see the opportunity there. So we'll see how that plays out, whether they actually get permitting. But at least in the pipeline, we're seeing bigger data centers than maybe we've seen in the past.

On Asia, look, China still remains dynamic, but the rest of Asia is where we're seeing growth. In fact, that's where we're also doubling down on some of our investments, especially on the channel side, and that would be adding account managers because we see a lot of opportunities in India, for example, in Malaysia, Thailand. So we think there's a lot of opportunities there that we want to make sure we're ready for and we're gearing up for it.

Jeffrey Sprague: And maybe just one quick follow-up on resi. Any significant difference in just the kind of level of activity, your volumes in your one-step versus two-step channel?

David Regnery: I don't -- Donny, I don't believe we saw a difference.

Donald Simmons: No, no.

David Regnery: Both were strong. I think Chris mentioned earlier, the sell-in, sell-through year-to-date is basically the same number. So nothing abnormal there, Jeff.

Operator: Our final question today comes from Deane Dray from RBC Capital Markets.

David Regnery: What's this rumor right here?

Deane Dray: Yes. Listen, all good things must come to an end at some point, but I'm ready for the next chapter.

David Regnery: Well, hey, congratulations, and you will certainly be missed. You're always such an insightful analyst, so wish you all the best.

Deane Dray: I appreciate that. And I also want to extend my welcome and congrats to Donny and the start of his new chapter.

Donald Simmons: Thank you very much, Deane. I appreciate that.

Deane Dray: Great. Well, listen, I know we covered a lot of ground here. I'd love to get any kind of update on your ambitions in liquid cooling and whether you need to do any capacity expansion. You've got LiquidStack, you got a really good presence in this market. I mean this is probably the fastest growth opportunity in data center today, and just would love to hear updated ambitions, if we could.

David Regnery: Yes. I mean, look, we don't have cold plates. I think you know that we have partners, obviously, that we work with so that we can model it so we can understand the impact that it has on the thermal management loop, at least, as we refer to that.

As far as immersion cooling, and I know you and I have had this conversation in the past, that's still out there a bit. There's some challenges there, but we have a lot of patents in that space. And it's very efficient. It's just got some infrastructure that we have to figure out how to make that in an economical way.

But look, we love data centers. We love innovating with our customers there, and we're going to continue to do that in the future.

Deane Dray: Great. And thanks for your kind words, and I'll be watching from the sidelines.

David Regnery: All right. Good luck to you. Take care.

Operator: And everyone, at this time, there are no further questions. I'd like to hand the call back to Mr. Zac Nagle for additional or closing remarks.

Zac Nagle: I'd like to thank everyone for joining today's call. As always, we'll be available for your follow-up questions at any time over the next several weeks. We'll also be on the road attending conferences and other marketing activities. So we look forward to seeing you soon. Thank you.

Operator: Once again, everyone, that does conclude today's conference. We would like to thank you for your participation. You may now disconnect.