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MANAGEMENT DISCUSSION SECTION

Good morning. My name is Virgil and I will be your conference operator today. At this time I would like to welcome everyone to the Ingersoll Rand Second Quarter 2018 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question and answer session. [Operator Instructions] Thank you. Zac Nagle, Vice President of Investor Relations, you may begin your conference.

Zachary A. Nagle

Vice President, Investor Relations, Ingersoll-Rand Plc

Thanks, Operator. Good morning and thank you for joining us for Ingersoll Rand's second quarter 2018 earnings conference call. This call is being webcast on our website at ingersollrand.com where you'll find the accompanying presentation. We are also recording and archiving this call on our website.

Please go to slide two. 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 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.

The participants on today's call are Mike Lamach, Chairman and CEO and Sue Carter, Senior Vice President and CFO. With that, please go to slide three and I'll turn it over to Mike. Mike?

Michael W. Lamach

Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

Thanks, Zac, and thanks to everyone for joining us on the call today. Please go to slide three. I'd like to begin with a brief review of the fundamental elements of our business strategy that drive long term value creation for shareholders. This is often a helpful starting point for those of you listening who may be less familiar with the company.

First our global business strategy is at the nexus of environmental sustainability and impact. The world is continuing to urbanize while becoming warmer and more resource constrained as time passes. We excel at delivering energy efficiency and reducing greenhouse gas emissions, reducing food and other waste of perishable goods and generating productivity for our customers, all enabled by digital and other exponential technologies.

Our business portfolio positioning creates a platform for the company to consistently grow above average global economic conditions aided by the strong secular tailwinds that I've outlines. Second, our business operating system is designed to excel at delivering strong top line growth, incremental margins and free cash flow. Our business operating system underpins everything we do and enables us to consistently generate powerful free cash flow which, when combined with our dynamic capital allocation strategy, drives strong returns for shareholders over the long term.

And finally, over the years, we've built an experience management team and a high-performance, winning culture which gives me confidence in our ability to deliver strong results that are sustainable for the long run. Having a strong, winning culture takes years to build and cultivate and I believe this is one of the things that the market may underappreciate about Ingersoll Rand.

As we consistently execute our strategy, we continue to build a stronger company that delivers reliable and consistent financial performance for shareholders over the long term.

Moving to slide four, midway through the year, we continue to execute well against our long term strategy and 2018 is shaping up to be a very good year for us. Our end markets are healthy and we are executing well as evidenced by the strong growth we're delivering in bookings and revenues in both our Climate and Industrial segments across virtually all products, services and geographies globally.

Our Industrial segment continues to perform well with broad based bookings and revenue growth and significant margin expansion. We're effectively managing inflation and tariff headwinds. We delivered a 10-basis-point positive price versus material inflation spread in the second quarter which reflects strong pricing discipline and efficiency. Our China growth strategy is performing well against our expectations with continued strong revenue and bookings growth and improving margins.

As we look forward, we expect our end markets to remain healthy with consistent execution of our business operating system which gives us confidence in raising our full year guidance for revenues, EPS and free cash flow. Please go to slide number five.

In the second quarter, we delivered strong growth in organic bookings and revenue across the board as indicated by the positive signs on the chart. Enterprise organic bookings and revenues were up 15% and 9% respectively. Climate led the way with organic bookings and revenues of 17% and 9% respectively. And Industrial was also very strong with organic bookings and revenues up 8% and 9% respectively. These results represent continued healthy end markets and consistent execution of our strategy.

A couple points to highlight. First, we did not see a significant impact from revenue pull-ins ahead of price increases or tariffs in the quarter, and Sue will discuss it in more detail later. And second, we didn't have any large performance contracting orders to call out in the quarter that would've skewed our results. The one minus on the chart was in small electric vehicle bookings, where results were only modestly lower. Golf was down with utility and consumer vehicles showing bookings growth as expected.

Please go to slide number six. This slide provides insight and color into the key drivers behind the chart on slide five and how we're thinking about the outlook for the year. In commercial HVAC, we're seeing sustained growth globally in both bookings and revenue, with good growth in both equipment and services and particular strength in Asia. North America growth remained solid, with gains in equipment, services, contracting and controls. Institutional growth was particularly strong, led by education, and industrial HVAC strength was also notable in the quarter.

Europe, the Middle East and Africa commercial HVAC remained strong with solid growth across the board in equipment and aftermarket, and we saw additional growth in services from our rental service business. China continued to have a very strong growth in the quarter led by the execution of our China direct sales growth strategy. Our outlook for total commercial HVAC remains healthy for 2018 and key economic and market indicators largely support our view.

Turning to residential HVAC, bookings and revenue growth were also very strong, particularly against tough growth comps versus 2017. The replacement markets where the majority of our sales are derived showed very good growth in the second quarter and this is expected to continue through 2018.

Our Transport Solutions business continues to be a diversified resilient business and the improving market conditions for North America refrigerated trailer have been a positive. North American trailer order growth was strong in the quarter and revenues were up as well.

The Americas Commercial Transportation Research Company, also known as ACT, has taken up their forecast for North American refrigerated trailers to approximately 5% growth over 2017. However, the industry capacity by trailer OEMs is constrained, so it's not clear how much the industry will actually grow at this stage.

Auxiliary power unit growth remained strong with good growth in both refrigerated and non-refrigerated segments. We're also seeing continued solid growth in Europe, the Middle East and Africa truck which is a meaningful business for us. Overall, the transport market should be stronger than we originally expected in 2018, primarily led by improvement in the North American trailer market.

Compression Technologies is seeing the continuation of an industrial recovery, consistent with industrial production and other key leading indicators. In the quarter, we delivered good growth in bookings and revenues in both equipment and aftermarket. All major geographies were solid with particular strength in Asia. For 2018, we expect to see solid growth broadly across key products, services and markets.

Small electric vehicle revenue growth was strong, driven largely by successful market penetration of our consumer vehicle and we expect that to continue through 2018. We also delivered strong growth across our Industrial Products business, which are comprised of tools, fluid management and material handling. We expect to see continued good growth in our Industrial Products businesses in the second half of the year.

And now, I'd like to turn it over to Sue to provide more details on the quarter and to discuss our 2018 guidance increase. Sue?

Susan Carter

Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc

Thank you, Mike. Please go to slide number seven. As Mike highlighted, strong momentum from the first quarter continued through Q2. Revenue growth in both our Climate and Industrial segments is outpacing our initial guidance expectations. Margins and leverage are improving and the pull-through to EPS growth has been strong. As we look forward to the second half of the year, we continue to see good opportunities for growth broadly across our end markets. We expect sustained, strong execution of our business operating system to enable us to deliver financial results that meaningfully exceed our initial full year guidance for revenues, earnings per share and free cash flow.

Looking at our second quarter results in more detail, bookings and revenue performance were both strong with robust growth in virtually every major product category and geography and in both services and equipment. We delivered record enterprise bookings and revenues with organic bookings up 15% and organic revenues up 9%.

Climate led the way with organic bookings and revenues up 17% and 9% respectively. Industrial organic bookings and revenues were also strong, up 8% and 9% respectively. Aftermarket growth outpaced equipment growth, up 12% and 11% respectively as we continue to focus on building out a greater mix of high margin, sustainable revenue and margin streams over time.

There's been a fair amount of discussion on the Street recently regarding the impact of customers' pre-buying inventory ahead of announced price increases or the anticipated implementation of tariffs, so we wanted to spend a moment addressing this question with respect to Ingersoll Rand.

While it is difficult to determine a precise number due to a number of factors, we are confident this was not a substantial factor for us in the second quarter given our channel structure and the visibility that we do have. We would estimate an impact of between $80 million and $100 million on orders spread primarily between commercial HVAC, residential HVAC and transport refrigeration. As best we can call it, this would translate into two to three percentage points of the 15% bookings growth in Q2. The impact of revenues was likely a fraction of this in the quarter and de minimis to the full year.

Through the second quarter, we have continued to execute a balanced capital allocation strategy. Our first priority is always reinvesting in high ROI projects in our business. As we outlined in our original guidance for the year, we also have a number of high ROI capital expenditure related projects in 2018. These projects are aimed at simplifying our business through footprint optimization and at innovation through new product development related projects. We've invested in a number of these higher ROI projects through the first half.

We've also maintained our commitment to a strong and growing dividend. We announced a quarterly dividend increase of 18% in the second quarter and have distributed $222 million to shareholders in the form of dividends in the first half of 2018.

Share repurchases have also remained a good investment for us as our shares have continued to trade below our calculated intrinsic value. Through June, we have repurchased $500 million at an average price of $88.53.

On the acquisition front, we closed on the Trane Mitsubishi Electric JV which is now up and running and our acquisition pipeline remains active. Through the second quarter, our total cash spend on M&A is approximately $280 million including the ICS Cool Energy acquisition and the Trane Mitsubishi JV which were previously announced. While it is still early days on the Trane Mitsubishi JV, we're already seeing good returns on the ICS Cool Energy acquisition.

Please go to slide number eight. As we've highlighted, Q2 was a strong financial quarter top to bottom. We delivered 9% organic revenue growth, 50 basis points of adjusted operating margin expansion, and EPS growth of 24%. Our operating leverage also significantly improved to approximately 20%.

Please go to slide number nine. Focused execution of our strategy and operational excellence drove strong core business operating income contribution from both of our business segments, which combined for approximately $0.25 or the majority of the $0.36 of EPS growth in the year-over-year quarter.

Lower share count from significant capital deployment toward share repurchases in 2017 and 2018 drove another $0.07 improvement. We also had modest positive contributions from lower interest expense associated with the company's debt refinancing earlier this year. Additionally, we benefited from a slightly lower effective tax rate year-over-year on higher pre-tax earnings.

Please go to slide number 10. Strong execution drove 50 basis points of adjusted operating margin improvement in the quarter. Pricing discipline delivered greater pricing efficiency than we anticipated when we gave guidance at the end of the first quarter. Price versus material inflation improved 50 basis points sequentially in the second quarter to a positive 10 basis point spread. Higher revenue drove 80 basis points of margin expansion and investment spend was consistent with our targeted levels of approximately 40 to 50 basis points of incremental investment per year.

Productivity versus other inflation was flat in the quarter but improved sequentially. We expect productivity to continue to improve in the back half of the year and particularly in the fourth quarter as programs and initiatives continue to ramp. We expect total productivity in 2018 to exceed 2017 levels.

Please go to slide number 11. Our Climate segment demonstrated strong improvement in the quarter with flat adjusted operating margins, which was a 50 basis point sequential improvement from the first quarter driven primarily by volume, pricing, and productivity. We are successfully mitigating persistent tier 1 and tier 2 inflation, freight costs, and the known impacts of the tariffs that have been implemented to date. As you know, the majority of inflation impacts are to the Climate segment. Our China direct sales strategy continues to perform well against our expectations with continued strong growth and improving margins as we move through the year.

Please go to slide number 12. Our Industrial business delivered another strong quarter with organic revenue growth of 9% and adjusted operating margin improvement of 170 basis points. The restructuring and productivity actions in prior years are providing operating margin growth in 2018 and we continue to take further actions in 2018 that will benefit future years.

Please go to slide 13. We remain committed to a dynamic capital allocation strategy that consistently deploys excess cash to the opportunities with the highest returns for shareholders. We maintain a healthy level of business investments in high ROI projects, which is helping to drive our strong growth in both our Climate and Industrial segments this year. We have also increased our capital expenditure investments that will have strong returns through new product development and footprint optimization.

We maintain a long standing commitment to paying a strong and growing dividend and have increased the dividend at a 20% compound annual growth rate over the past five years. In the second quarter, we announced a quarterly dividend increase of 18%, which reflects our ongoing confidence in our ability to drive sustained high levels of cash flow in the future.

We will continue to make strategic investments in value accretive M&A that drives long term shareholder returns. We maintain a strong balance sheet that continues to improve through high quality operating income growth. This provides us with significant optionality as our markets continue to evolve. We also continue to invest in share buybacks when the shares trade below our calculated intrinsic value. Over the past year and a half, we've spent $1.5 billion on share repurchases and have reduced our outstanding share count by approximately 5%.

Please go to slide number 15. As we touched on earlier, our strong first half financial performance gives us confidence in raising our 2018 guidance for organic revenues, adjusted earnings per share and free cash flow. Adjusted earnings per share guidance moves up significantly to approximately $5.50. Organic revenue guidance is more than doubled to a range of between 7% to 8%, reflecting very strong revenues and bookings in the first half and expectations for continued healthy end market growth and continued share gains in the second half. This strength is also broad based.

By segment we expect Climate and Industrial organic revenues to each be up 7% to 8%, essentially doubling our prior guidance for revenue growth for each business segment. Please go to slide 16. This table lays out our updated guidance versus our prior guidance in more detail. We've talked to most of the data points on this slide, so we've included the table in the presentation for your reference and it includes some of the modeling related questions you'll want to have. Bottom line is that we expect 2018 to be a strong year for Ingersoll Rand.

Please go to slide number 18. Moving on to our topics of interest section, we have one primary topic to cover: tariffs and inflation mitigation. The main takeaway is that we have incorporated all known direct and indirect impacts into our guidance from the Section 232 tariffs and the Section 301 tariffs related to the first $50 billion that went into effect in July.

We're evaluating the potential impacts from the additional $200 billion in proposed Section 301 tariffs which are indeterminate at this stage. To be clear, we have seen a significant uptick in inflation from the direct and indirect impacts of the known portions of the Section 232 and 301 tariffs. At the same time, however, with the pricing effectiveness we're seeing and expect to see going forward, we believe we can maintain a flat price versus material inflation equation in the back half as we previously guided.

We expect the better pricing we are seeing to offset additional inflation in tariffs in the back half of the year. Beyond the known tariffs, we continue to closely monitor the tariff proposals and discussions taking place globally in order to react quickly if and when additional tariff pressure comes into play. First, our global integrated supply chain team is continuously monitoring tariffs from the time they are proposed.

Second, we are rigorously addressing the cost increases across the portfolio working through our supply chain team. And third, we are utilizing our business operating system to actively manage our pricing and productivity actions and pipeline throughout the enterprise. We anticipate that additional tariffs would be met quickly by pricing action across the industry.

Now I'd like to turn the call back to Mike for closing remarks before we take Q&A. Mike?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

Thanks, Sue. Please go to slide 19. We believe the company is extremely well positioned to deliver strong shareholder returns over the next several years. Our strategy is firmly tied to attractive end markets that are healthy and growing profitably. Our products and services portfolio is at the nexus of global energy efficiency and sustainability megatrends, which provides a tailwind for growth above average economic conditions over the long term. So unless you believe the world is getting less populated, cooler, and less resource constrained, these secular megatrends will continue to create growth opportunities for Ingersoll Rand.

We have experienced management and a high performing team culture that incorporates operational excellence into everything we do. Culture is so fundamental to a company's success yet it is often underappreciated in the short-term. For us, it is a sustainable competitive advantage that we invest in heavily to cultivate and maintain.

And lastly, our business model generates powerful cash flow and we are committed to dynamic and balanced deployment of capital. We have a strong track record of deploying excess cash to shareholders over the years.

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

QUESTION AND ANSWER SECTION

Operator: We will now take questions. [Operator Instructions] Your first question comes from the line of Steven Winoker from UBS. Please go ahead.

Steven Winoker
Analyst, UBS Securities LLC

Q

Thanks. Good morning. Impressive performance for sure.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Good morning, Steve.

Zachary A. Nagle
Vice President, Investor Relations, Ingersoll-Rand Plc

A

Morning, Steve.

Steven Winoker
Analyst, UBS Securities LLC

Q

Morning. Hey. I just wanted to come back to a couple things. One is, I guess, the order pull forward and the second one is on Climate margins. On the order pull forward from Q3, could you give us a little more color around that and how we should expect that to materialize over kind of timeframe? And do you think this is just a one quarter phenomenon? Or you think there's going to be a little bit more of this? Just anything on that front would be helpful.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Yeah. Steve, so half of it would've been really in commercial HVAC and then a small portion would have been residential, very small, balance being TK for the most part. So that would total something in the $80 million range.

What I'd say to you is that, and I don't necessarily talk about sort of third quarter, but I will say we looked at what was happening with bookings in the first few weeks of July very carefully and they came in very strong. So I don't think that there's going to be an issue there for us with any hiccups in the quarter.

Steven Winoker
Analyst, UBS Securities LLC

Q

Okay. That's helpful. And then on all the puts and takes around Climate margin performance, can you give us a little more color there too in terms – I know you walked through some of the price/cost inflation dynamics, but and tariff impact and all these other items. But maybe just a sense for investment, inflation. The pricing's already out there. Just something to help us think about that flat margin performance on the go forward.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Sure. I think for the full year 2018, Steve, the best way to think about that, the headline would be that I'd expect Climate margins to improve say 10, 20 basis points overall. And the pricing is then loaded in. And the productivity is something that across the company I always talk about the health of the pipeline. We look to make sure that 125% of what we need is in the queue.

The calendarized version, or the part of the productivity pipeline that is being worked comes down to a monthly and quarterly view. And that monthly and quarterly view would support the productivity side. So I would say with bookings where they are and the health of the end markets with pricing, the effectivity of pricing being good, what I mean by that is the pace at which price was received and to the extent we were able to get the price that we were looking for, it's as good as I've seen. The productivity calendarization looks good. When you net that all out, I think you end up with 10, 20 basis point improvement for the full year implying a pretty good back half.

Steven Winoker
Analyst, UBS Securities LLC

Q

All right. That's helpful. And I could just sneak one more in, on the Trane Mitsubishi JV that launched, what kind of financial impact are you thinking about on that as you move forward?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

2018, it's not necessarily that material to the company, but the early days have been, it's been excellent. It's been exciting and the teams are off to a great start. They're active in the market and its performing as we would have hoped. So, all systems are go and positive on that front.

Steven Winoker
Analyst, UBS Securities LLC

Q

All right. Look forward to hearing more later. Thanks.

Zachary A. Nagle
Vice President, Investor Relations, Ingersoll-Rand Plc

A

Thanks, Steve.

Operator: Your next question comes from the line of Steve Tusa from JPMorgan. Please go ahead.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Morning, Steve. You might be on mute.

Charles Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Hello?

Zachary A. Nagle
Vice President, Investor Relations, Ingersoll-Rand Plc

A

Go to the next question.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Oh, there he is. Steve?

Charles Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah. Can you hear me now?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Got you.

Charles Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Oh, great. Sorry. Yeah, I don't think I was on mute. So guidance implies some slowing in the Industrial margin expansion after really strong obviously results here. Anything going on there? Is there a mix impact or anything like that in the second half?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Actually, we think Industrial remains strong. Everything is pointing forward. We're looking at probably a two year high now in terms of Industrial productivity. We're seeing strength across the world. We're seeing services grow at about the rate of equipment. So no, I think for the most part we see sort of steady as she goes in Industrial.

Charles Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And any reason why price/cost would – why would price/cost would decelerate in the second half if these price increases are going through? Is the inflation just that much worse in the second half?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Well, you've got a little bit of that first $50 billion in tariffs coming through in July and August on those two.

Charles Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

So I think that the safe view of that at this point would be the original guidance we have which is a flat back half. We saw great price effectivity in the second quarter. It was beyond what we thought. But yeah, I think we need to pace ourselves based on changes that happened with tariffs the dates of implementation as how those looks might change. But we think that we're managing it really effectively and that we've got a plan and contingencies around how to manage changes that we would get on the tariff front.

By the way, it's not just tariffs; it's inflation. We really have a region for region strategy. And so if you think about the impact we're seeing, it's not so much on the actual tariff. It's on the derivative effect of commodities in the region increasing because they can as a result of tariffs.

Charles Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. One last quick one on resi. What do you think the market – I mean Lennox was up nine, Carrier was mid-single digits. So the market's kind of all over the place a little bit here. What do you think the market's going to kind of shake out at for the second quarter for resi?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Yeah, I think the market data was released already, Steve, so we grew share in the quarter. We know that. And if you look across the board, and I know you'd love the detail on this, but let me just tell you that on the Climate segment itself, when you think about the revenue growth rate for the segment, we didn't have more than one point of variance globally across HVAC or transport or residential. So it was really good uniform performance. And then North America specifically, when you look at applied unitary and service, everything there was say 15%, 16% plus growth. And so that was really strong across the whole range which probably tells you what you're asking I think at that point.

Charles Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Wow. Okay. Great result.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Thank you.

Operator: Your next question comes from the line of Jeffrey Sprague from Vertical Research. Please go ahead.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Thank you. Good morning, everyone.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Morning, Jeff.

Zachary A. Nagle
Vice President, Investor Relations, Ingersoll-Rand Plc

A

Morning.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Hey Mike just a little bit more color on price. I think earlier in the year there was a lot of optimism you could get it in the U. S. but a lot of doubt, or certainly less certainty about rest of the world. Your results here do suggest that price is moving up pretty nicely now in those markets. But could you give a little bit more color on kind of the geographic differences around price, and if you're maybe still playing a bit more catch-up outside of the U.S.?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

There's not a lot of variability around price effectivity around the globe for us at this point, Jeff, and that's part of, if you will, the surprise here. So the margin improvement in China is going really well and that would've been the point we would've been talking about a couple of quarters ago, but that's going really well. And there's not enough differentiation globally to really kind of point out here in that space.

Now, I mean, clearly we're covering and have been covering material inflation in every business with the exception of our global commercial HVAC business and what we're seeing there is that that gap is flattening and improving with the increase that have been put out in the marketplace.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

And how about capacity, Mike? A good news result in year like this. I would assume you're sweating the assets a little harder than you thought. Any material change in investment or anything that you need to do to keep up with this?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Jeff, we're ready to build and ship more so send us orders and we'll get it to you. Yeah, no, it's a good time and we need to make hay when the sun's shining. We all understand that and that's what's happening. So we don't have any capacity issues at this point in time.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

I'm sorry, just one other quick one. Maybe Sue has calculated this number. But if you're at price/cost parity, how much margin pressure just arithmetically does that create?

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc

A

I'm not sure I understand.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Well, revenues will be higher because of price, but profit's not up because you're neutralizing cost with price. So there's a arithmetic margin headwind. If you haven't done the math or don't know it, that's fine. Just curious.

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc

A

Yeah, I haven't done the math. But what I would say, Jeff, is when we think about this through the entire P&L is we're not just working off of that equation. We're working off of all of the different elements. And so as we point out to you on productivity, we're continuing to put productivity projects into the pipeline because there are other elements that are inflationary and moving around in the P&L, too.

So we can certainly come back to you on that answer. But my general overall answer is I'm going to manage everything that is on the P&L to get to the guidance that we've provided and that we're going to hit for 2018.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Jeff, a good example here is that it's one of the better gross productivity years, if not the best in terms of the absolute dollars that we've ever had. So although the bridge shows that to be flat, that's absorbing 20 basis points of freight in that equation as an example that wouldn't have been planned which will show up a bit in price. So this stuff, to Sue's point, is moving around between price and productivity and it improves in the back half of the year. But to get to the arithmetic math, the arithmetic equation there, we'll follow up with you.

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc
A

Yeah.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

Appreciate it. Thank you.

Operator: Your next question comes from the line of Andrew Kaplowitz from Citigroup. Please go ahead.

Andrew Kaplowitz
Analyst, Citi Research
Q

Morning, guys. Nice quarter.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Hi, Andy.

Andrew Kaplowitz
Analyst, Citi Research
Q

Mike, obviously your intention in China has been to accelerate growth through moving to the direct sales model and you did mention that one of the highlights of your overall growth this quarter is China HVAC. Can you give us a little bit more perspective on that growth in the region? Maybe how much of it is coming from your own initiative here versus what the HVAC market is doing over there.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Yeah. The market is growing something in the 5% range so we're growing in multiples of the market there. And it's in the areas that we would expect which is the applied systems and some of the larger infrastructure projects and in some of the geographies that we weren't covering as deeply as in the past. So that is the strategy. That's what's being executed. It's being executed very well and the margin profile and linkage to service continues to improve. So it's been a great success. It's probably one of the greatest successes we've had in the past year or so has been that whole strategy and I would expect that to continue.

Andrew Kaplowitz
Analyst, Citi Research

Q

Got it. And you don't adjust and tweak that strategy given all of the tariff stuff that's going on between us and China, correct?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Well, same equation in China applies here. We build about 95% of what we sell in China in China and the supply chain is localized. So it's the same equation as we have here region-in-region.

Andrew Kaplowitz
Analyst, Citi Research

Q

Got it. And then, look, you delivered almost 9% organic revenue growth across the first half of 2018. You mentioned the 15% bookings tailwind. Maybe a little bit of pull forward as you talked about, but it's not affecting 3Q. So the implied organic growth for the second half, let's call it 6% to 7%. Is that just conservatism at the midpoint or is there anything that you would worry could slow down the second half, or it's just sort of steady as she goes?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Well, some of the bigger growers in the quarter would have been applied and it would have been Compression Technology's equipment. So in essence we're building 2019 as we speak. And I would say a lot of that is our view toward building a profile for 2019.

Andrew Kaplowitz
Analyst, Citi Research

Q

Got it, that's helpful. Thanks, Mike.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Thank you.

Operator: Your next question comes from Julian Mitchell from Barclays. Please go ahead.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Thanks, good morning. Just wanted to circle back on the Industrial segment if you could give any color within compressors, any specific markets or regions that you thought gave the orders a particular lift? And also on the Industrial segment in general, following up on an earlier question, I mean the margin guide implies sort of flat margins I think sequentially in the second half which is quite unusual in Industrial, particularly given the sales trends. So I don't know if there's any extra color you could give on why that's the case.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Yeah, in terms of the market, we called out Asia specifically and that's true. It was really across all of the oil free technologies which would be centrifugal and oil-free rotary combined. But also strength in some of the quick ship or the quick book and turn business short cycle compressors were strong as well. Service growth across the board is really stepping up. That team has done an outstanding job of taking the operating system for sales excellence and really putting that into how they manage for daily improvement. And so the coverage of the market, the activity we're seeing through that coverage in the market is much stronger than we've seen in the past. So that's part of the playbook that we actually stole from the HVAC China business if you will in terms of how we're thinking about covering the market more fully and differently there. So, but North America was good, was strong as well. We saw that in contact cooled technology. We see that in plant air. Centrifugal, sort of going into general industry, that's been good as well.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Understood. And then just on the margins sort of half-on-half in Industrial, is there anything particularly weighing on that back half in terms of higher investments, or at this point do you think you've raised the margin guide enough for now and we'll just see how Q3 plays out?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

No. We wouldn't do that. If we thought it was better, we'd roll that through but that's the roll up we've got at this point in time and some of that's going to be a combination of mix and timing of projects. So I think it's a good forecast where we think the year is going to end at this point.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Great. Thank you.

Operator: Your next question comes from the line of Joe Ritchie from Goldman Sachs. Please go ahead.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

Thanks. Good morning, everyone.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Morning, Joe.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

Maybe just to clarify Jeff's question from earlier, when you guys made the comment around margin parity, price/cost parity in the second half of the year, you were talking about margins, not on a dollar basis, right?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Talking about margins. Right.

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc
A

Yeah.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Absolutely.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

Okay. Got it. Got it. Yeah, I think that that probably clarifies it. Maybe talking about the growth that you're seeing specifically on Climate and into 2019, Mike, can you provide maybe some color on some of the orders that you're booking that could potentially be longer cycle that could start benefiting 2019 as well?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Yeah. I mean, we're seeing, again, there's very little variability between unitary, applied, controls and service. It's just a strong healthy global environment for us really all regions of the world. There were no large performance contracts in there and something that would skew the results. That's really important to know. So because you're seeing such strength in applied, you're generally finding longer lead projects. And so if anything, there, again, you're building quarter one, quarter two of 2019 backlog, which we're already well into that based on customer timing.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

Cool. That's good to hear. And then, I guess my follow-up there is really just price/cost is better than we expected this quarter. I was just wondering, did you benefit at all of from the pullback that we started to see in copper? And then what are kind of like your assumptions for the key commodities into the second half of the year?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Well, really it's the best press price effectivity I've seen in 33 years I've gone through this, both in the urgency to get it done and in the ability to maximize what it was that we were asking for. So the combination of that got us a bit ahead of the curve which is great; further along than we thought we'd be in Q2.

And then the ability to absorb the first $50 billion into the pricing that we've put out in the marketplace would be the success there. So as it relates to copper specifically. We ladder and hedge and so yeah, it's great that things are moving down, but as you enter quarter three in the back half of the year, a smaller percentage of the spend is really in the spot market. We begin to lock that in. So if it continues, we'll see some benefit, but that would be reflected in the locks we would be doing going into 2019 at this point.

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc
A

Yeah. I think that's right, Joe. And when we think about that, the goal that I would have is to get ourselves to the point where in 2019 that that blended rate gets through our locks and that dollar cost averaging that we're doing on a copper buy comes down overall. So we never lock, as we told you, to the full amount of the commodity, 75% at the beginning of a quarter. So we do get some benefits on any purchase that we're going to make from those prices coming down. But I would look at that as more of an opportunity for 2019 as we go forward. So it's always good because we are always buying all three of the commodities. So we'll certainly take advantage of any price drops that we get.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

Perfect. Good to hear. Thanks guys.

Operator: Your next question comes from the line of Nigel Coe from Wolfe Research. Please go ahead.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Oh, thanks. Good morning.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Hi, Nigel.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Hey, Mike. Obviously you've covered a lot of ground here and you provided good detail so I haven't got huge amount here. But I imagine you're pretty paranoid about the sustainability of the strength and obviously 15% growth is not going to be sustained. But as you look beyond July and look at the front logs RFP activity, customer conversations, what do you think you see in the next six months or so? And are we still looking at a double-digit type order cadence here? I mean, any cause of concern? Any color there would be very helpful.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Yeah, I mean globally as we track proposal activity and we look at what's happening in the market, Nigel, things are strong all over the world for us. And it fundamentally comes down to in most parts of the world, it's a replacement business; 80%, 85% of most of what we're seeing in North America, Europe for sure and the Middle East is going to be replacement business. And even China and some of the newer economies are 50%-50% in terms of replacement, new construction.

And so what's happening as when you can build an equation, economic value and a payback related to energy productivity energy efficiency, and if we're able to couple that with a story that helps customers achieve their greenhouse gas emission or sustainability goals, there's a demand creation opportunity out there that's really not factored into how people might look at particular put in place or market data across the globe.

So it truly is a secular tailwind tied to this whole nexus of energy efficiency and sustainability. And I think that that's a long lived phenomenon. You heard me in my opening and close that really relates to the fact that I think as you see more urbanization, you see more pressure on energy and the environment and you think about what businesses we're in, where HVAC is such a major contributor to building efficiency and to greenhouse gas emissions followed by transport refrigeration followed by industrial processes, we're in the right businesses to have an impact. And so I think that's a big part of it. The product portfolio, the investments in controls and digital, the investments in the channel really just go to support that model that we think is the right model.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Thanks. That's great color. And then just on the service trends, we don't typically see service growing high single digits. And I know that a lot of that's due to your internal initiatives around connectivity, et cetera, and just obviously a lot of investments there as well. But is there any signal here that – we've seen utilization picking up, particularly in the Industrial side? And is there some sense here that we've got some Ace equipment out there which require more MR activity and then perhaps that could signal further activity on OE side.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Well, I mean, services was actually mid-teens and it's so unusual to see when equipment grows mid-teens, you get services growing mid-teens. But it really comes down to the whole sales excellence work being conducted across the company and that bearing fruit really over time. And even parts of the world, historically, places like China where, I can imagine in the next three to five years, you're seeing the same sorts of linkage parity that you're finding in Western Europe and in the U.S. And so, that is certainly impacting service growth.

Rental is another one. We think that's an important part of the strategy to be able to backstop customers' uptime requirements, as well as an opportunity to provide seasonal equipment and to create service opportunities through the rental business. And so, that's helping us in that regard as well. As far as Industrial...

Nigel Coe
Analyst, Wolfe Research LLC
Q

Right. And Industrial...

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Industrial – yeah, go ahead.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Please. Go ahead, Mike.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

You might want to just ask the second part of your question, the point you're interested, it was industrial productivity?

Nigel Coe
Analyst, Wolfe Research LLC
Q

Just – no, more on the industrial compressors, whether we're seeing increasing utilization of those machines driving service or just more internal IR?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Well, you're definitely seeing utilization rates across most of the economies in the world increasing up to critical points where you're finding expansion opportunities. So, to me, what's really happening in the Compression Technologies business is the market coverage we're taking on and the investments we're making in covering the service opportunities in the market has taken on a whole different sense of urgency. That connectivity strategy that Todd talked about for really a couple years at this point in time is something that's showing up in the results in a meaningful way.

Nigel Coe
Analyst, Wolfe Research LLC
Q

And then, just a quick one, Mike, on mix in residential. One or two of your competitors talked about slight negative mix in U.S. resi. Did you see that at all in your business?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

No. Not at all. Simple answer, no.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Great. Thanks Mike.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Thank you.

Operator: Your next question comes from Rich Kwas from Wells Fargo. Please go ahead.

Rich M. Kwas
Analyst, Wells Fargo Securities LLC
Q

Hi. Good morning, everyone.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Morning.

Rich M. Kwas
Analyst, Wells Fargo Securities LLC
Q

Hey Mike, on the performance contracting project, so nothing this quarter. Earlier in the year you said some things could hit. But at this point is it fair to say that that's all going to come in 2019?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

No. I think that we could see Q3, Q4. I think these are sort of landing gears down on a couple of these. So I think that quarter three, quarter four would be my guess.

Rich M. Kwas
Analyst, Wells Fargo Securities LLC

Q

And would those have some sort of mix-down impact on – it'd be enough to have a negative mix impact on Climate on the margin side?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

No. No, it wouldn't. The contribution there is going to be just fine. In gross margins you'd see it a little bit, but contributions will be accretive.

Rich M. Kwas
Analyst, Wells Fargo Securities LLC

Q

And institutional orders consistent with overall Climate orders, growth, organic wise?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Yeah. I mean, really, you're seeing applied, which I would link to Institutional, growing at the same rate as unitary, growing at the same rate as service.

Rich M. Kwas
Analyst, Wells Fargo Securities LLC

Q

Okay. And then two, just a question on M&A contribution. Earlier in the year you had $0.05 or $0.06 from deals done in 2017, in terms of the EPS contribution for 2018, and then something like $0.15, $0.16 for 2019. Are those numbers coming in better?

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc

A

Well, so what you did see, as we look at the M&A activity that has impacted cash flow in the first half, so $286 million, that is the announcement that, or the committed transactions, the ICS Cool Energy as well as Mitsubishi that we had committed at year end. But I think one of the things that I would do, Rich, just as you think about this is, I'll step you back to almost a capital allocation and sort of broaden out your question, which, as we think about capital allocation we think about investing in the business first, having a strong dividend second, and then having the remainder split off between M&A and share buyback, if the stock's trading below its intrinsic value.

If you look at the first half of 2018 and I follow that along. So we've got heavier CapEx in 2018 related to some of the footprint optimization as well as the new product development that I talked about in the prepared remarks. So that's actually $163 million. We've got the dividends that we talked about of $222 million. We've also got the share buyback of $500 million and the M&A of $286 million. So in the first half of the year, we've actually deployed over $1 billion of the excess cash that we've got. And so M&A's a part of it. We're going to continue to look at the pipeline, but I just wanted to take the opportunity to point out how strong the capital allocation has really been in the first half.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Rich.

Rich M. Kwas
Analyst, Wells Fargo Securities LLC
Q

Yeah.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Specifically on the deals done, they're integrating well and we're achieving what we thought we would achieve which had a high threshold. So I don't think anything changes with the guidance we gave you around 2018 and 2019 around contribution.

Rich M. Kwas
Analyst, Wells Fargo Securities LLC
Q

Okay. Okay. Great. Thanks. Appreciate it.

Operator: Your next question comes from the line of Steve Volkmann from Jefferies. Please go ahead.

Stephen Edward Volkmann
Analyst, Jefferies LLC
Q

Hi. Good morning, guys. Thanks for taking the question. Maybe a couple quick philosophical things, if I could. First on Thermo King, based on the data we see, it doesn't really look like the fleets of trucks and trailers are actually growing that much which would suggest that what we're seeing here is kind of a technology upgrade and I know there's much better energy efficiency with the more recent units. But how long do you think that can last? I mean, where are we in the process of upgrading the fleet do you think?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Well, I mean from a U.S. perspective first, you've got tight shipping capacity, you've got regulatory changes, you've got the impact from U.S. Tax Cuts and Jobs Act, immediate expensing, all that's going to drive some opportunity. You're right, I mean, technology is a major difference. If you think about what's going across the road in refrigerated trailer really in a Class A tractor, the need to manage the diesel engine and reduce fuel consumption, to manage the refrigeration cycle, the energy and any greenhouse gas emissions coming off those units and to supplement that with auxiliary power units when the vehicles are idling, it's a big opportunity that I think continues for a long period of time. I mean, ultimately like you're seeing with consumer vehicles, you're going to see more electrification of that over time. And that's certainly what we're doing now with some of the hybrid applications as well as telematics investments that we've made across the portfolio.

Stephen Edward Volkmann
Analyst, Jefferies LLC
Q

Okay. That's helpful. Thanks. And then even maybe a little more broad picture. At some point, I suppose all these price increases we should start to worry about some demand destruction in certain end markets. And some of the pricing we're hearing, especially in the HVAC, is pretty impressive. And I guess I'm just curious how you think about when that starts to crimp growth, or maybe it doesn't. I don't know. Maybe these markets are consolidated enough now. But I'm curious how you think about that and how you might even sort of measure and monitor it?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Well, history would say that it doesn't happen, that there isn't disruption over time. And so, I rely a lot on history and I would also rely a lot on the discipline that happens within the industries themselves, and so the structure of the industry. It's something we do look at, but we're not seeing any changes to historical patterns here.

Stephen Edward Volkmann
Analyst, Jefferies LLC

Q

Okay. I appreciate it. Thanks.

Operator: Your next question comes from Joel Tiss from BMO. Please go ahead.

Joel G. Tiss
Analyst, BMO Capital Markets (United States)

Q

Ah, I made it. I just had one or two little ones. Can you break out the bookings in Industrial by the different product lines? Just because there've been a couple of questions around the edges of that. I think that would just clear a lot of things up.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Joel, Club Car was the weakest, just marginally negative and the strongest would've been CTS and material handling, albeit material handling being smaller business, but CTS would have been additive, Club Car would have been dilutive, and power and fluid management right in the hunt there. So that's the rundown there.

Joel G. Tiss
Analyst, BMO Capital Markets (United States)

Q

So you won't give us numbers. All right. And then and can you talk about...

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

I probably gave you enough of the algebra there that a smart guy like you, Joel, will handle that. So...

Joel G. Tiss
Analyst, BMO Capital Markets (United States)

Q

Once I run out of fingers, I'm done.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

All right.

Joel G. Tiss
Analyst, BMO Capital Markets (United States)

Q

And can you just give us a little sense on the second half share repurchases that are baked into the guidance? And also are there any larger acquisitions that, over the next 18 months, like you can fuzz it up a little bit, but just a little color on anything bigger that might be percolating. Thank you.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Well, let me do the second part first. Sue can tell you about share buyback. But on the first part, nothing has changed with regard to our methodology, the discipline, about how we're thinking about M&A. I think about 80% of what we look at in M&A are assets that we know and think fit the portfolio. 20% are always the good ideas that come in from additional sources that get evaluated to see if we're missing something or there's a fit.

So nothing's changed there with regard to how we look at the pipeline, how we manage it, how we think about it strategically, or how we compare that to other alternatives including share buyback. And Sue, you may want to comment on share buyback.

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc

A

Yeah, on the share buyback, the way that we model this, Joel, for purposes of the guidance is absolutely consistent with where we started out the year. So we put a placeholder in for $500 million, which, as you know, we've completed. But that isn't the capital allocation strategy. The capital allocation strategy says we're looking to deploy the excess cash and that we're going to look at the M&A pipeline as well as more share buyback to absolutely finish out the capital deployment for the year. So, the model today with the guidance is consistent with where we started out the year with the $500 million.

Joel G. Tiss
Analyst, BMO Capital Markets (United States)

Q

All right. Thank you very much.

Operator: Your next question comes from Deane Dray from RBC Capital Markets. Please go ahead.

Andrew Krill
Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning. This is Andrew Krill on for Deane.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Hey.

Andrew Krill
Analyst, RBC Capital Markets LLC

Q

So, going back to the trucking and freight shortage and issue, I think one of your competitors noted they had a pretty, a meaningful impact in June for resi HVAC. So, I just want to – did you guys see any of that? And can you just update us on how the costs in freight and shipping are tracking year-over-year? I think you said around 15% up previously. Thanks.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

You know, I said actually refrigerated freight mile is up about 30%, which is great for our TK business and we were seeing dry freight at that time up in the market about 15%. I didn't actually say what our rate increases were.

I did say earlier on the call though that there's a 20 basis point impact in the productivity other inflation bridge that we've got. So if you take that bridge which shows flat, there's a 20 basis point headwind associated with freight in that number. So that's the impact that we're seeing.

Andrew Krill
Analyst, RBC Capital Markets LLC
Q

Okay. And then...

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

And then – hey, Andrew, and a lot of the productivity initiatives – not a lot, but a number of productivity initiatives in the third and fourth quarter are looking at ideas that we've got around freight and warehousing. And so, that's sort of an exciting thing that we're thinking about. We started that about a year ago. It's a bit fortunate, if you will, that we've got that kind of teed in for the Q3, Q4 of this year so that should help with that equation dramatically.

Andrew Krill
Analyst, RBC Capital Markets LLC
Q

Got it. And then on the resi, did you have any impact on just shortage of being able to ship resi units in this quarter? Or maybe in 3Q so far?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Nope. We'll ship all you want. Again, send us your orders. We're happy to do that and we've got no problem building them and shipping them.

Andrew Krill
Analyst, RBC Capital Markets LLC
Q

Got it. And then just as a quick follow-up on the – back to the China HVAC strategy. Just with all the tariffs and say around in U.S. and China, have you seen any kind of blowback against the U.S. brands in general? Or is the value proposition still that they really don't care at this point?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

Well we employ a lot of people in China. We've got factories and technology and product built for the market. And so in China, we think about ourselves as a Chinese company. In the U.S., we think about ourselves about it as a U.S. company. Fundamentally we're a global company and we've got to act that way in the markets that we serve. So to your question simply, no. We haven't seen any reaction to that one way or the other.

Operator: Your next question comes from David Raso from Evercore ISI. Please go ahead.

David Raso
Analyst, Evercore ISI Group

Q

Hi. Good morning.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Morning.

David Raso
Analyst, Evercore ISI Group

Q

On the organic sales guidance increase, the 3.25% to 7.5%, how much of that was higher price than you previously assumed?

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Have to think about that. There really was a second price increase which would have happened depending on the business kind of midway through the year. So we wouldn't have had a lot in there for meaningfully – I mean, certainly would have looked at material inflation and new news around freight 232 and 301 and we were trying to get on top of that as it was happening. So David, I'll probably have to come back and answer that. But it's not something meaningfully popping out on the bridge to say that that is a such a difference from where we were originally.

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc

A

No, because David, the way that I would think about that is with the pricing and generally again, your pricing realization in the neighborhood of 1% to 2% is going to kind of flow through. So it might move the growth slightly but it's not going to be the biggest factor in changing the growth. It's really coming out of the volume that's occurring out of the end markets as opposed to pricing, or FX, or acquisitions, which basically are having about the same impact as the original guidance.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

David, I'd probably say, maybe a point to 120 basis points for the full year would be price. Everything else is going to be pretty well in volume.

David Raso
Analyst, Evercore ISI Group

Q

Yeah, so that's not all new pricing from the previous guidance, right? That's full year, what you ...

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Right, all. That's right.

David Raso
Analyst, Evercore ISI Group

Q

I mean the reason I ask is when you look at the segments, and I don't know if it's conservatism or as you said a lot of the inflation's in Climate, but you just raised your revenue guidance for Climate $475 million, but you only raised the EBIT, $46 million right? So basically a 9.7% incremental profit on incremental sales you're now looking for. And that sort of begs the question, are we really seeing price versus cost maintains the margin? Or price of $100 offsets cost of $100? So just to be clear, we're saying price/cost does not erode the margin the rest of the year, especially in Climate or is it – no. It's $100 of cost get offset by $100 of price and yes that does dampen the margin but at least we're offsetting it in dollar terms. It's just the incremental margin on Climate just seems low on what you just raised the sales by.

Susan Carter
Chief Financial Officer & Senior Vice President, Ingersoll-Rand Plc

A

Right, but I'm thinking out loud, David, as we go through this. But I think what you have to do with all of this is you can't just parse out a couple of pieces. And it really is important to understand that the majority of the big inflationary items are occurring in the Climate segment of the business and that as we're looking at the Climate segment itself, over the second quarter, you're actually seeing an improvement in the overall margins for the quarter. So we're offsetting the headwinds and continuing to improve margins in the business.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Hey, David, I guess our math's a little bit different too, by the way. I mean, to get to a 10, 20 basis point expansion in Climate for the full year we're going to have to get something like 50, 60 basis points of improvement in the back half of the year. That implied leverage organically of somewhere between let's say 23% and 25%. So we'll at least take...

David Raso
Analyst, Evercore ISI Group

Q

The incremental margin year-over-year, it is 23%, but I'm talking about literally what you just raised in sales and EBIT which you would think is incremental.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Ah. Well, [indiscernible] (01:02:02)

David Raso
Analyst, Evercore ISI Group

Q

Well, that's why I asked the pricing question. If it was simple, look, I raised revenue in Climate by you name it, the $475 million. But half of it was price and all I'm doing is offsetting cost, then I can appreciate why the incremental profit on that sales is modest. Right? We're just trying to understand is there conservatism in that number or when you look at Industrial, that same math on the way you raised the sales $114 million, you are dropping through 36% more profits. So is the messaging here that yeah, the inflation's in Climate. That price/cost might be a drag on margin but we're more than making up for it in Industrial and thus the whole company has price/cost, no margin drag.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc

A

Yeah, high level...

David Raso
Analyst, Evercore ISI Group
Q

I think that is the thing we're trying to figure out.

Michael W. Lamach
Chairman, President & Chief Executive Officer, Ingersoll-Rand Plc
A

High level, David, I'd say that, as Sue said to you, the 232 and 301 really hit the Climate segment much more, if not almost exclusively with the Industrial business. And so to my mind, you've got more headwind there to offset. There is more price in the back half obviously than there would be in the first half. You've got direct material inflation which continues in the second half to be a bit larger than the first half. But shoring up the math to the raise, we can work with you later on and kind of compare notes.

Operator: There are no further questions at this time. I would like to turn the call over to Zac Nagle for closing comments.

Zachary A. Nagle
Vice President, Investor Relations, Ingersoll-Rand Plc

Great. I'd like to thank everyone for joining for today's call. And wanted to let you know that we'll all – we'll be around for questions today, tomorrow, this next week and the coming weeks. And we look forward to seeing you on the road in the coming weeks as well. Thank you.

Operator: This concludes today's call and you may now disconnect.