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PRESENTATION

Operator

Good morning. Welcome to the Ingersoll Rand 2019 Q2 Earnings Conference Call. My name is Chris, and I will be your operator for the call. The call will begin in a few moments with the speaker remarks and then a Q&A session. (Operator Instructions)

Zac Nagle, Vice President of Investor Relations, you may begin your conference.

Zac Nagle – VP of IR

Thanks, operator. Good morning, and thank you for joining us for Ingersoll Rand’s Second Quarter 2019 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 2. Statements made in today’s call that are not historical facts are considered forward-looking statements and are made pursuant to the safe harbor provisions of federal securities law. Please see our SEC filings for a description of some of the factors that may cause our actual results to differ materially from our anticipated results.

This presentation also includes non-GAAP measures, which are explained in the financial tables attached to our news release.

Joining me on today’s call are Mike Lamach, Chairman and CEO; and Sue Carter, Senior Vice President and CFO.

With that, please go to Slide 3, and I’ll turn the call over to Mike.

Michael Lamach - CEO

Thanks, Zac, and thanks, everyone, for joining us on today’s call. I’m proud of our team’s performance in the second quarter. Once again, we’ve delivered strong revenue growth, margin expansion and EPS growth. We welcomed our new Precision Flow Systems team into Ingersoll Rand, and we’re well underway towards a separation into 2 stand-alone businesses and our proposed strategic combination with our Industrial segment in Gardner Denver.

With that backdrop, let's get started. Please go to Slide 3. I'd like to start with a brief overview of the global business strategy that we're executing to deliver consistently strong financial results for our shareholders. Fundamentally, our strategy is at the nexus of environmental sustainability and impact, which are strong secular tailwinds for our business. The world is continuing to urbanize while becoming warmer and more resource-constrained as time passes. We excel at reducing the energy intensity of buildings, reducing greenhouse gas emissions, reducing waste of food and other perishable goods, and we excel in our ability to generate productivity for our customers, all enabled by technology.

Unless you think the world is getting cooler, less populated, less resource-constrained as time passes, these strong secular tailwinds will continue to provide opportunity for shareholders and purpose for our vision.

As we continue separation, integration planning and business transformation activities related to our strategy and combination of our Industrial segment with Gardner Denver, the move towards creating the premier pure-play climate business in 2020, our aggressive pursuit of excellence in delivering solutions to mitigate the impact of these secular trends only intensifies. Our Climate business squarely focuses 100% of our portfolio at the nexus of sustainability and global environmental impact where our products and services can reduce the impact of these mega trends and create a platform for the company to grow above-average global economic conditions.

Moving to Slide 4. I'll spend a few minutes discussing how 2019 has progressed through the first half of the fiscal year and what we're expecting to see through the balance of 2019. The key takeaway is that we remain bullish on our strategy, our end markets and our ability to execute using our business operating systems to deliver against our organic revenue growth and adjusted EPS guidance ranges for fiscal 2019. In fact, today, we're raising EPS guidance by $0.05 to approximately $6.40 and expect to deliver top-tier financial performance again in 2019.
Our residential HVAC business had strong mid-single-digit growth in the second quarter, and we expect this business to continue to deliver strong performance for the full year, supported by a solid residential replacement market.

In our Industrial segment, we saw healthy order growth in long-cycle projects in our Compression Technologies business in the second quarter, and we have a favorable outlook for continued long-cycle growth in the second half of the year. Conversely, the short-cycle market softened in the second quarter, primarily impacting revenue growth in our core Compression Technologies and Tools businesses, which were both down low single digits. We expect short-cycle markets to continue to be challenging throughout 2019. The positive impact of healthy long-cycle markets presents a positive setup as we move into 2020 when these orders convert into revenue and operating income, given the long lead times associated with these projects.

Price realization has been outstanding across our businesses, and we’re effectively managing all inflation and tariff-related costs with an 80 basis point spread in the second quarter. As we’ve highlighted before, we have been effective in managing inflation, and we expect to continue to maintain a positive spread at our target range of 20 to 30 basis points in the second half of the year when we begin to lap the strong price realization in the third and fourth quarters of 2018 and when we begin to see the full impact of the increase in List 3 tariffs on Chinese imports moving from 10% to 25%.

Lastly, we continue to expect strong free cash flows in 2019 of equal to or greater than 100% of net income, which will further strengthen our balance sheet, enable us to maintain good optionality. We’ve deployed significant capital on dividends, acquisitions and share repurchases over the years, and again, in the first half of the year. We’ll continue to follow our dynamic and balanced capital allocation priorities and expect to deploy 100% of excess cash over time.

Please go to Slide 5. We delivered solid bookings and revenue growth in virtually all businesses and regions in the second quarter. On the bookings side, our largest HVAC businesses continue to lead the way and delivered strong growth, with North America and Europe HVAC up high single digits in the second quarter. China was also healthy with low single-digit growth against a very tough comp of low 20s growth in the second quarter of 2018. We also drove strong bookings growth of 8% in our Industrial segment versus a tough comp of 8% in the prior year, led by Compression Technologies and Small Electric Vehicles. Compression Technologies’ growth was driven by strong growth in long cycle, partially offset by softness in the short-cycle markets. Small Electric Vehicles’ growth was driven by successful execution of our consumer vehicles strategy.

Transport refrigeration had a significant decline in bookings against very tough comps in 2018, for reasons we’ve discussed in detail in prior calls. However, as we’ve said before, these declines don’t impact or negate the strong growth in our other Transport businesses or impact their ability to grow revenues in 2019 and ’20.

The Transport refrigeration business had extremely strong bookings in 2018 is returning to historically normal levels of bookings in 2019, but with backlog that’s more than 2x historical levels. With the strong backlog and solid bookings we’re seeing in 2019, we expect this business to deliver solid revenue growth in 2019, and the prospects heading into 2020 continue to look promising.

On the revenue side, our largest HVAC businesses continue to deliver very strong growth with North America, Europe and Residential, all up mid- to high single digits in quarter 2. Transport refrigeration also delivered strong revenue growth.

Bringing all the pieces together, we’re pleased with our organic bookings and revenue growth performance through the first half. We expect organic revenue growth rates to increase heading into the second half based on healthy backlog, deliveries and incoming order rates, and remain confident in our 5% to 6% organic enterprise revenue growth target for the full year.

Please turn to Slide 6. We’ve outlined a number of takeaways for each major business on the next 2 slides. Commercial HVAC continues to be very strong, particularly in North America and Europe. Our backlog, incoming order rates and pipeline of projects are driving confidence that we’ll continue to see solid growth in the second half of the year. Residential HVAC is led by North America trailer, truck, APUs and aftermarket. Based on our record backlog and healthy incoming order rates, we remain confident that our Transport business will deliver another solid year in 2019.

Please turn to Slide 7. At our Compression Technologies business, we’re seeing healthy growth in long-cycle markets and softness in short-cycle markets. The long-cycle business strength positions us well for good growth in late 2019 and in 2020 as these orders convert into revenue. Small Electric Vehicles is having a great year, driven by successful execution of our consumer vehicle strategy.

And now I’d like to turn it over to Sue to provide more details on the quarter. Sue?

Susan Carter - CFO

Thank you, Mike. Please go to Slide #8. I’ll begin with a summary of a few main points to take away from today’s call. As Mike discussed, we drove strong financial results in the second quarter with adjusted earnings per share of $2.09, an increase of 13% versus the year ago period. Our Q2 performance gives us confidence in our ability to execute against the full year growth and margin targets we provided in our guidance at the beginning of the year. As a result, we are raising our full year adjusted continuing EPS guidance to approximately $6.40, up from approximately $6.35 that we communicated last quarter.

Second quarter organic revenue growth was strong, particularly in our Climate segment. We also saw strong organic bookings across most of our major businesses. When excluding our Transport business that saw outsized order growth in 2018, organic bookings were up approximately mid-single digits for both the enterprise and our Climate segment.

In our Industrial segment, organic revenues were up 2%, compounding on a tough comp of 9% organic growth in the prior year. Strong revenue growth in CTS services and Small Electric Vehicles offset the weakness in the Industrial short-cycle market Mike mentioned previously. Industrial organic bookings were strong, up 8% and compounding on an 8% growth rate in Q2 2018, fueled by long-cycle Compression Technologies growth and Small Electric Vehicle demand. Despite ongoing trade and tariff negotiations, CTS China bookings growth continued to strengthen in Q2, providing cautious optimism going forward.

During Q2, we expanded adjusted operating margins 80 basis points and delivered 37% operating leverage, which is ahead of our
full year expectations. We continue to leverage our business operating system across the enterprise to manage direct material, tariff-related and other inflationary headwinds. As we look to the back half of the year, we anticipate we will continue to realize price to effectively manage material inflation and tariffs, including the recent increase in List 3 tariffs on Chinese imports from 10% to 25%, but this spread should narrow as we lap the 2018 midyear price increases.

As Mike mentioned, we continue to expect strong free cash flows in 2019 of equal to or greater than 100% of net income. We exit the second quarter with working capital sufficient to support our ongoing cooling season demand, and we expect working capital requirements to approach the long-term target of approximately 4% of revenues by the end of the year. Importantly, we continue to deliver on our dynamic capital allocation strategy. So far this year, we have completed the strategic acquisition of Precision Flow Systems for approximately $1.45 billion, deployed approximately $259 million in dividends and approximately $250 million on share buybacks. Looking forward, we expect to consistently deploy 100% of excess cash over time.

Please go to Slide 9. We delivered organic revenue growth of 4%, adjusted operating margin improvement of 80 basis points and adjusted earnings per share growth of 13%. Organic revenue growth was led by strong broad-based growth across our Climate segment. Continued disciplined focus on pricing and productivity actions enabled us to effectively manage inflation and tariff-related headwinds and drive margin expansion across the enterprise.

Please go to Slide 10. Our Climate segment delivered another strong quarter of operating income growth, enabling us to drive solid year-over-year EPS growth in the quarter. Our Industrial segment delivered solid results. Our full year Industrial margin outlook remains intact.

In addition to good segment performance, second quarter corporate costs were lower than prior year, impacting results by approximately $0.05. The cadence of corporate expenses is lumpy in 2019, driven primarily by the timing of stock-based compensation that is not linear as well as the timing of a number of other functional spending items. The full year corporate cost guidance of approximately $250 million remains unchanged.

Please go to Slide 11. In Q2, strong execution drove 80 basis points of adjusted operating margin improvement. Price versus material inflation was positive for the fifth consecutive quarter. Pricing net of material inflation expanded margins by 80 basis points, reflecting strong carryover price from 2018 and incremental pricing actions in 2019. We delivered solid margin expansion from volume growth in the quarter. Margin expansion was tempered by softness in short-cycle industrial revenues, which tend to have higher margins. Consistent with our full year expectations, we continue to deliver productivity in excess of other inflation. We continue to heavily invest in our business. Incremental Q2 investments of approximately 40 basis points were fairly evenly weighted between growth and operating expense reduction projects.

Please go to Slide 12. Our Climate segment delivered another strong quarter of with 5% organic revenue growth and adjusted operating margin expansion of 50 basis points. Consistent with our expectations, we delivered strong volume growth, price realization and productivity.

Please go to Slide 13. Our Industrial business delivered solid organic revenue growth of 2% against a tough comparison of 9% growth in Q2 of 2018. Industrial leverage was impacted primarily by the inclusion of the PFS acquisition midway through the quarter. PFS acquisition revenues lever at operating income margin rates instead of gross margin rates for the first year under our ownership. Additionally, as I mentioned previously, margin expansion was tempered by softness in short-cycle industrial revenues, which tend to have higher margins. Excluding these factors, leverage in Industrial was north of 30% in the quarter.

Looking at the EBITDA margins. The PFS acquisition was an immediate contributor to our EBITDA margin expansion of 60 basis points in the quarter.

Please go to Slide 14. 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 technology, innovation and operational excellence projects, which are vital to our continued growth, product leadership and margin expansion. We have a long-standing commitment to have a reliable, strong and growing dividend that increases at or above the rate of earnings growth over time. We continue to make strategic investments and acquisitions that further improve long-term shareholder returns, like the PFS acquisition completed during the quarter.

Earlier this year, we secured an additional $1.5 billion in senior notes, taking advantage of the current favorable interest rate environment. We remain committed to maintaining a strong balance sheet that provides us with continued optionality as our markets evolve. We continue to see value in share repurchases when shares trade below their intrinsic value, and we expect to consistently deploy 100% of excess cash over time.

Please go to Slide #16. The integration of Precision Flow Systems with our existing ARO business is underway and is progressing according to plan. We expect PFS to contribute approximately $400 million in revenue on an annualized run rate. That equates to approximately $250 million of incremental revenue in 2019, with approximately $50 million already delivered in Q2. EBITDA margin expectations for PFS remain unchanged with percentages in the high 20s, and adjusted operating margins are expected to be in the mid-teens for 2019. PFS is expected to be cash flow accretive, consistent with the EBITDA attribution in 2019. For your reference, we have also included estimated non-GAAP adjustments related to PFS for the year.

Additionally, we completed a senior notes offering in March, which we anticipate will add approximately $60 million in interest on an annual run rate basis, $47 million incremental to 2019. For 2019, we expect the adjusted operating income of PFS to essentially offset incremental interests from the senior notes offering.

Please go to Slide #17. I want to take a moment to further clarify the impact of PFS on our full year 2019 revenue guidance. As you can see on the chart, adding approximately $250 million of PFS revenues to our prior revenue guidance range increases our Industrial reported revenue growth rates by approximately 7.5 points and our enterprise revenue growth rates by approximately 1.5 points. There is no other change to our revenue guidance changes for 2019.

Please go to Slide #18. When we are on the road, we often get questions about the status of the strategic announcement we made at the end of April to combine our Industrial segment with Gardner Denver. We continue to be excited about the prospects of creating a premier industrial company as well as a leading pure-play Climate solutions company focused on HVAC and transport refrigeration. I’ll give you a brief update today.
One of the transaction closing conditions was recently satisfied. The HSR Act waiting period expired. We will continue working through the remaining regulatory and other closing conditions. We anticipate approximately $150 million to $200 million in separation and transaction-related costs, including the estimated costs of separating legal entities. We also expect to mitigate the approximately $100 million in stranded costs by the end of 2021. This is unchanged from what we communicated last quarter. In preparation for closing, we have begun 3 separate work streams. The first work stream is focused solely on the separation of our Industrial segment. After years of leveraging across our Industrial and Climate segments, we have tasked the separation team with separating Industrial segment business processes, systems and functions. This includes technical and financial operating processes including tax and systems, manufacturing operations and supply chain services, real estate, along with all business regulatory filings. There is a lot of work to be done, and the team has a methodical road map to work this out.

The second work stream centers on integration planning with Gardner Denver. Given that we continue to operate as 2 separate companies and compete in the marketplace until the close of the transaction, the integration planning work must be managed under clear rules and antitrust protocols. While integration preparation is underway and will continue over the coming months in compliance with these rules, much of the work to integrate the 2 companies will take place after the expected close.

The final work stream is focused on the transformation efforts of our Climate segment. As we plan and execute within the transformation work stream, we have the advantage of building on an incredibly strong foundation with great businesses, engaged and talented people and a distinctive winning culture and core values. Our strategy focused on reducing the world’s energy intensity and greenhouse gas emissions remains unchanged. We are focused on delivering a new Climate structure that allows us to better serve our customers and unlock value for shareholders. At this point, this work is early on, and we'll give more updates at a later date.

All in, we're well underway in the strategic transaction, and we believe we are on track for closing in early 2020.

And with that, I'll turn the call back over to Mike.

**Michael Lamach - CEO**

Thanks, Sue. Please go to Slide 19. In summary, we are pleased with our first half performance and we expect to deliver strong revenue and EPS growth and free cash flow in 2019. Looking forward, we continue to believe the company is extremely well positioned to deliver strong shareholder returns over the next several years.

Fundamentally, our strategy remains at the nexus of environmental sustainability and impact. Today, 15% of the world’s carbon emissions come from heating and cooling buildings and transport refrigeration creates another 80 million metric tons of CO2 emissions annually, which can be eliminated through electrification over time. We are bending the global warming curve by changing the way the world heats and cools buildings and moves refrigerated cargo. New technology we've developed can reduce up to 99% of the emissions that come from heating and cooling a commercial building, and this doesn't include the substantial environmental benefit of increasing system energy efficiency to reduce both power generation at the source and storage requirements.

We're continually working to innovate in this way to electrify heating, electrify diesel engines used to cool trucks and trailers that transport perishable goods and to reduce the energy intensity and greenhouse gas emissions in residential and commercial buildings.

We recently announced our 2030 ESG commitments to meet the challenge of climate change while increasing access to air conditioning, perishable foods and medicines and improving the quality of life for people and communities where we operate and serve. We are committing to reduce our customer carbon footprint by 1 gigaton of CO2 through our HVAC and transport refrigerant products and services. We believe this is the largest customer climate commitment made by any B2B company, and our math shows that this reduction could equate to 2% of the world’s emissions. For size and scale, that's equivalent to the annual emissions of Italy, France and the U.K. combined.

We continue to transform our supply chain and operations to have restorative impact on the environment, including achieving carbon-neutral operations and giving back more water than we use in water-stressed areas. We are committed to increasing opportunity for all, strengthening economic mobility and bolstering the quality of life of our people. This includes gender parity in leadership roles, a workforce reflective of our community populations, maintaining livable, market-competitive wages and broadening community access to cooling, comfort and healthful foods.

We've been investing heavily for years to build franchise brands and to advance our leadership market position to enable consistent profitable growth. We have an experienced management team and a high-performing culture that instills operational excellence into everything we do. We remain committed to dynamic and balanced deployment of capital, and we have a strong track record of deploying excess cash to deliver top-tier shareholder returns over the years.

Lastly, we're extremely excited about the proposed transaction and the strategic combination of our Industrial segment with Gardner Denver. Combining 2 of the premier complementary industrial companies offers the opportunity to drive significant innovation and growth with meaningful revenue and cost synergies, supported by secular growth trends and diverse end-market exposure.

We're also very excited about creating the premier pure-play HVAC and transport refrigeration company with our existing Climate segment businesses. We have a tremendous opportunity to leverage a simplified business model and structure and sharpen our sustainability focus with our investments. Our Climate businesses have clearly differentiated performance, and we see significant opportunity as a pure-play to build on this performance for our employees, customers and shareholders.

And with that, Sue and I will be happy to take your questions. Operator?
unitary front, how are trends in that part of the business this quarter? And what do you expect for the rest of the year there?

**Answer – Michael Lamach:** Resil was strong in the quarter, bookings and revenue. We think it continues for the balance of the year, we think the market might be low single-digit, mid-single-digit, Steve. We think it will be mid-single digit for the year there. So that's progressing. Again, as you know well, it's 80% replacement. We're heavily indexed there. Anything we do incrementally with new construction is actually an add. That's growth for us. We feel like we're in a great position.

With regard to Commercial North America, we're seeing strength in unitary. We're seeing strength in applied and services. We are seeing particular verticals like K-12, labs, data centers that are growing nicely. So no letup there.

And then just to anticipate some questions I think that people may ask, if you think about our backlog today across the globe from HVAC perspective, we're up 21% year-over-year and even up sequentially from quarter 1 to quarter 2. So that is, I think, indicative of just continued strong markets and a solid pipeline going forward.

**Answer – Charles Tusa:** Great. And then so you think you guys are taking share? It sounds like. Obviously, some of the other guys that put up numbers that are obviously not as good as that.

**Answer – Michael Lamach:** Well, in the markets that we get really good data, third party, which is the easiest to look at, absolutely, that's a fact. Yes.

**Answer – Charles Tusa:** And then lastly, just third quarter. Can you talk about seasonality? Do you expect normal seasonality here in the third quarter? I know things are moving around in the global economy. And also orders. Do you think orders are going to take another step down? And how do the compares look so that maybe we're more stable here in low single-digit type of number for Climate? I know you don't like to guide that, but there's obviously a lot of moving around in the economy. I'm just curious how you guys see that playing out.

**Answer – Michael Lamach:** I don't see any changes really in sort of HVAC globally. I think we've got a pretty good read on the global landscape. Most markets are strong, and there's pockets where there's weakness, but surprises where markets are strong. Example of that would be Mexico has gone through a couple of quarters of negative GDP. It's a pretty big market for us. So that's new information, but we're relatively strong in an equivalent market in the southern cone of Latin America. It's that sort of thing on the edges that we're looking at. But the markets remained strong.

There's a lot of focus on ThermoKing. I think we've done a decent job explaining the constraints that exists in 2018 at Class 8 tractors and how customers wind up in advance really to pull on that supply capability. It translated down through trailers. And of course, all translated to those customers ordering either APUs or refrigerated trailers. The actual uptick time of how the heartbeat of a plant runs and we match trailers and units to actual tractors or trailers, it's very smooth. And that backlog generates just mid-single-digit revenue growth. That's been pretty consistent. So noises around the TK bookings. But again, you just have to separate that from the 28 constraints with our customers and think more about HVAC market being strong and Transport just generating solid revenue growth and good backlog and generally healthy markets. And we're still seeing good order intake rate at Transport. So it's not as if things are drying up even on the order inputs either. Just tough comps.

**Answer –Operator:** Your next question comes from Julian Mitchell of Barclays.

**Answer – Julian Mitchell:** So maybe just sticking to the 2-question rule. My first question would just be around the Industrial division. It looks like, on Slide 17, you're still assuming maybe 5% organic growth this year. That seems to imply a step up from the first half. So maybe just help explain why you think Industrial organic growth should reaccelerate in the second half, please.

**Answer – Michael Lamach:** Yes. I think we've got our eyes wide open on the short cycle, and we've accommodated that in our forecast. We have strengthened longer cycle, some of which we expect to ship in the fourth quarter a lot will ship in 2020. We have excellent growth in our consumer related strategy to small electric vehicles. So Julian, we've just finished the 5 plus 7 forecast not even a month ago. We had an opportunity to update that last month with the risks and opportunities. I think that we feel pretty good about that forecast. I look back at the beginning of the year relative to guidance, I would say that Climate markets are trending toward maybe the upper end of that and Industrial markets maybe would be trending toward the lower side of that. But net-net, we feel like we're right where we need to be in terms of the guidance that we gave.

**Answer – Julian Mitchell:** And my quick follow-up would be around the Climate division. You had about 7% profit growth in the second quarter, a bit of a step down from Q1. And then you're sort of guiding for a pickup in the second half. Similar question, I guess. What drives you think that slightly better EBIT growth in the second half? Maybe it's actually with resi versus commercial versus Transport or something on the margins around price material? Any color at all on that aspect?

**Answer – Michael Lamach:** Yes, Julian, I mean, when you look at leverage, first of all, in the quarter, we actually had really good leverage. We had leverage above gross margins there north of 30%. And we were able to be right about 30% for the first half of the year. So the question probably relates to what you're thinking to be a step down in the revenue. But again here, when you look at 21% year-over-year backlog and sequentially improving backlog from quarter 1 to quarter 2, known deliveries, and the service business being about half of the business, the amount of book and turn we need to do is actually, as small as I can remember it. So again, I feel pretty good about the revenue number. And I think that, that segment, in general, leverage is pretty close on the full year at the 25% rate we guided to originally. So I'm not seeing a lot of weakness there.

**Answer – Operator:** Year next question comes from Scott Davis of Melius Research.

**Answer – Scott Davis:** Sometimes when you are executing a kind of deal like this of this size, there tends to be a little bit of a letdown ahead of the closing. In some companies, we see they have to adjust compensation plan and such to prevent that. Have you guys -- do you feel the need to do anything? Have you done anything? Is there a risk that there's a little bit of distraction amongst the operating heads walking into the back half of the year here?

**Answer – Michael Lamach:** We've got over the years a wonderful operating system that is in terms of the metrics and many of the early warning indicators that we would get, Scott, feel good about seeing that. Of course, we are seeing none of it today. But the more important thing we're doing, though, is organizing ourselves in a way that we can compartmentalize what needs to happen and then think about interdependencies between things. So as an example, our #1 priority is to run the business and to run it well every day and execute on commitments we made. The second priority is the separation itself. Of course, there's no integration without the separation. So there's a separate team focused on separation that does not involve the integration team, which is the
that -- what might mean, of course, of the cost structure to maybe speed to market in some cases. It's really exciting. But we tried to make sure that the teams are different people, to the extent we can. Of course, a group like tax is going to be related to all 4 of those activities, but we're doing a pretty good job of compartmentalizing that and running it and using the metrics that we've always used to run the business.

Answer – Scott Davis: Okay. That's helpful. And just as a quick follow-up, and this -- I know this it's always hard to answer a question around market share around the HVAC side. But sometimes, I mean it's clear that you're gaining share. But sometimes, that's due to geographic mix or the type of projects that are growing. I mean is there a kind of a no-BS answer to that question of why you think you're winning. And not the usual we're better than the rest kind of stuff. Is there any other explanation you can give that would be helpful in that regard?

Answer – Michael Lamach: We've really designed our technology and go to market strategy around sustainability and around eliminating both emissions and reducing efficiencies so this passion around having the most energy efficient commercial systems out there in the world today using the most responsible refrigerants that we can put into these systems, leveraging the analytics, the data, the controls around that to put more sophisticated service offerings together. The belief that on that Commercial side we need to be doing that ourselves, not through independent distribution, because of the complexity of what it takes to model, sell, service, deliver against those plans. That's our strategy, and we've been consistent about that and just executing hard against that. I think from a goal deployment perspective, again another core part of the operating system, there's no mystery in the company as to what our goals are, what's expected, what we're measuring. So that -- it's just coming together in a way that is worked, Scott, over a long period of time.

Answer – Operator: Your next question comes from John Walsh of Crédit Suisse.

Answer – John Walsh: So I guess just going back to the price/cost spread you talked about, the 20 to 30 basis points here in the back half. I guess I understand the tariffs, but just kind of looking also at recent price increases, and I realize they're not all created equal. It does look like you pushed through some kind of another round of healthy price here across the commercial parts of your portfolio. I mean is that -- should we view that as a kind of a conservative placeholder for the back half? Or is there something else that would kind of make that decelerate further?

Answer – Susan Carter: What I would say is when you think about how we called price cost for the year, we're basically in line with how we called it. So we knew that we were going to have some great price comparisons on a year-over-year basis in the front of the year. And we knew that in the back half of the year we were going to lose some comparision last year. So prices going to actually be -- it's not a deceleration at all, but the comparisons to price in the back half of last year are going to result in a little bit less of a spread than in the first half of the year. But in terms of expectations, that's exactly what we would have expected. The prices are going through. They are sticking and are actually being realized in the business. And material inflation is actually doing approximately what we thought it would do for the year, which is we've got the tariffs covered. We've got all of the elements of costs covered, and we're seeing a little bit of material stabilization.

But again, stabilization to our expectations in the back half of the year and a little bit of deflation, but given the way that we buy materials, probably more of a 2020 impact. So when I think about the whole price cost, to sort of put it in the basket, I think the price comparisons are more difficult in the back half of the year than the front half of the year. Material inflation is doing about what we expected, and that gives us roughly the 20 to 30 basis points of spread for the entire year on price costs. I mean maybe it's a skosh conservative but it looks like we thought how it would look, which is really good part of that.

Answer – John Walsh: Okay. And then I guess just as a follow-up, if we could maybe look at the Americas or maybe actually drill down into the U.S. versus China, what you saw in terms of service versus equipment growth in the quarter?

Answer – Michael Lamach: Yes. Both are progressing well there, John. Always surprised at the degree of service penetration in China, how quickly that's maturing. So there's really no surprises there. And from a service perspective, we continue to do well there. So not much more to say there. Obviously, the U.S. and Europe are the gold standard around penetration and linkage, and then China is quickly, over the years, coming to that point. And over the next 5 years, I think it will be at the same level as our North American and European penetration.

Answer – Operator: Your next question comes from Nigel Coe of Wolfe Research.

Answer – Nigel Coe: I want to turn back to Industrial and the long-cycle bookings growth that you called out, and -- I mean I think we're all sort of thinking CapEx kicked down the road, perhaps some of these projects push out. But where are you seeing the bookings strength? Will you call out any end markets in particular? And then switching to the shorter-cycle pressure you've seen, would you say that's mainly inventory reductions or genuine end-markets weakness?

Answer – Michael Lamach: Yes, Nigel, I would call out Asia in your first question. Probably, we're seeing the long-cycle bookings. And here, you're seeing chemicals, manufacturing, energy.

Answer – Susan Carter: Air separation.

Answer – Michael Lamach: Air separation would be another, for sure. So that will be what I point out there. With North America, with the U.S. in particular, there was a slowdown it seemed after there was a flurry in the USMCA discussions between Mexico and the U.S. on the possibility of the U.S. imposing additional tariffs if Mexico wouldn't secure the border from the Mexican side. Roughly after that, we saw a slowdown. I think it was certainly an end-user demand, and that obviously affects the sell-through of distribution of short-cycle products there. It bounced around a little bit but off kind of that lower level. So hopefully, all that gets cleaned up permanently and I think that will have a restorative impact on short cycle. And if it does, I think there will be a nice bounce up when there's certainty around that.

Answer – Nigel Coe: And then digging back to the North American commercial as a quick follow-on. I think some of the peers saw weakness within the commercial unitary markets and (inaudible) on the replacement side and what impacts we call out there? Did you see that as well? Would you call out that commercial as weaker in North America?
focus is on market share and margin expansion as it is for every product growth team we have inside the company. So those are 2
out in the field and just make sure that those are where we want them to be. There's likely different structures that will evolve
everything -- obviously, from a name and a brand, all the way through the simplification of legal entities, the way that we might look

Answer – Andrew Obin:
muddling around kind of flattish, we've had bookings growth and revenue growth that's been in that high teens, low 20s range now

Answer – Andrew Obin:
the world. I would just say the booking rates there for us for multiple years have been extraordinary. We've said, I think in '16, that
institutional building, any data center, any industrial building in Europe, they've got the same requirements that they've got all over

Answer – Michael Lamach:
What kind of conversations are you having with customers in Europe regarding HVAC? And are you seeing any structural changes
regions in the U.S. where it can be hot or cold. So weather was particularly uncooperative given their exposure. I mean how does
your footprint kind of contrast with that, if at all?

Answer – Michael Lamach:
Yes. I think you're largely talking about what consumers might think. But if you think about any

Answer – Jeffrey Sprague:
No, Nigel. It was exceptionally strong for us. So no. I would say would be a highlight of the quarter as opposed to a weakness. I can't tell you why it would be different, but I can tell you it was a standout in the quarter.

Answer – Jeffrey Sprague: Mike, you never liked to mention weather -- Nigel just threw it out. Anything in the resi business that you thought was discernible? And you ran your inventories pretty lean, but is there anything kind of in the early setup in the third quarter, an overhang from that, that would be of note?

Answer – Michael Lamach: No. It was a little bit last year of some prebuy. I think that got pulled in the second quarter. That's really the only kind of -- it wasn't a big number, but it was a little bit of a compare difference there. I think a number of companies said that happen. No not really, Jeff, to answer your question. I think it's just fundamentals remain strong. I think that consumer generally still feels pretty good, pretty healthy. And we're not seeing any changes to that.

Answer – Jeffrey Sprague: Bigger picture, Mike, I was wondering if you could elaborate a little bit more on what you mean by transformation. I think the idea may still be kind of coming into view, but it seems like you've got a relatively crystallized view of where you want to take things. It will just be interesting to get a little bit perspective now kind of 3 months since making the announcement kind of what you're thinking about kind of pure-play transformation.

Answer – Michael Lamach: Yes. The starting point, just to be clear, is something that we're all very proud of over 10-plus years. And so transformation is not meaning it's something bad, it's something good. It means it's an opportunity here to really go think everything -- obviously, from a name and a brand, all the way through the simplification of legal entities, the way that we might look like the way support services are performed across the company. We will apply the same value stream mapping that we would do in a manufacturing process to the way record to report or procure to pay or any kind of order to cash process would work. We'll look through our field organization and understand how that would pan out in terms of incentives and some of the metrics that are out in the field and just make sure that those are where we want them to be. There's likely different structures that will evolve when you answer those questions. I think with the goal toward customer focus, a goal toward simplification, being tighter on some of the investment focus on our core sustainability themes. All those things I think are exciting to people inside the company because we're building off a piece of -- a strong foundation.

Answer – Operator: Your next question comes from Gautam Khanna of Cowen and Company.

Answer – Gautam Khanna: Just a follow-up maybe on Jeff Sprague's question. You mentioned the year-over-year on orders, the pull forward last year. But just speaking about Q2 '19, did you see any difference on the resi HVAC side between your indirect and direct channels? And maybe if you could speak to -- Lennox on their call talked about being over-indexed to some of the swing regions in the U.S. where it can be hot or cold. So weather was particularly uncooperative given their exposure. I mean how does your footprint kind of contrast with that, if at all?

Answer – Michael Lamach:
Answer – Michael Lamach:
Answer – Jeffrey Sprague:

Answer – Operator: Your next question comes from Gautam Khanna of Cowen and Company.

Answer – Gautam Khanna: That's helpful. And then just as a second question. Maybe can you give us some color on your expectations for Thermo King growth next year given what we're seeing in the truck market and what you have as offsets in the APU penetration and like you said the backlog running into next year? Any preliminary view on that?

Answer – Michael Lamach:

Answer – Michael Lamach:

Answer – Jeffrey Sprague:

Answer – Operator: Your next question comes from Andrew Obin of Bank of America.

Answer – Andrew Obin: Just a question. There’s been a lot of articles, I think the Wall Street Journal had an article how the Europeans are still reluctant to embrace HVAC even despite sort of climate change and the heatwave that you’re seeing in Europe. What kind of conversations are you having with customers in Europe regarding HVAC? And are you seeing any structural changes in adoption rates?

Answer – Michael Lamach:

Answer – Andrew Obin: I think I was referring more office buildings in Europe in August you certainly have a different idea of what HVAC is versus North America. So I was wondering if requirements are changing. But we can take it off-line.
Another question is on supply chain. Are you guys thinking where and how you’re spending CapEx given all the uncertainty that’s taking place?

**Answer – Michael Lamach:** Are you meaning uncertainty in the economy? Uncertainty where?

**Answer – Andrew Obin:** No, I'm thinking about trade uncertainty. And are you thinking -- are you changing where you spending CapEx globally? And are you sort of having conversations with your supply chain about moving some sources?

**Answer – Michael Lamach:** When we think about our CapEx, there’s been little difference to how we think about it because we want to make things where we sell things, and that's generally what we've always done. And I would say there’s even a stronger concentration of that than there was 5 years ago. That’s been our strategy.

As it relates to the supply chain, it depends. Where there is an easy answer, yes, we’ll look for an opportunity there if we can, and we’ve made some movement there. So the answer to your question is, from our own footprint perspective, we’re continuing to do what we do from a supply chain perspective, around the edges, there's things that we do to move supply where we can.

Andrew, just to beep in to your question. I'm just going to follow up. I know you’re off the line here, but it's interesting a lot of the Chinese customers that we have that we’re looking to move production away from China to maybe avoid some of the U.S. China tariffs, were thinking about Mexico as well. I think that some of what they’ve done and decided has changed over time. And I think we’re seeing more in areas like Vietnam, as an example, as opposed to Mexico. So there are changes with our customers in terms of how they’re working their footprint for sure.

**Answer – Operator:** Your next question comes from Nathan Martin from Seaport Global.

**Answer – Zachary Nagle:** There’s no Nathan in the call queue. I think you got the wrong person.

**Answer – Operator:** Joe Ritchie from Goldman Sachs.

**Answer – Joseph Ritchie:** Maybe my first question, Mike, just focusing on Climate operating leverage for the quarter. And so obviously, like price cost came through well. It seems like the leverage is maybe a little bit lighter than we expected. Was there anything that impacted Q2 just from a mix perspective on the Climate side? Is there anything out of the ordinary?

**Answer – Michael Lamach:** So Joe, I've got 32%. Were you expecting more than that in the quarter?

**Answer – Joseph Ritchie:** Then my assumptions on price costs must be slightly different.

**Answer – Michael Lamach:** Okay. I'm just taking $40 million of operating income on $124 million revenue rise, and that's what I'm looking at.

**Answer – Joseph Ritchie:** All right. I can take it off-line. I was trying to strip out the price cost component and trying to really determine what the volume leverage was, and it seemed like it was a little bit lower than anticipated. But that's okay.

And then I guess maybe just kind of sticking on the commodity, the price cost question and Sue your comments earlier on it being as goes conservative in the second half of the year. I guess as you’re thinking about commodity inflation in 2H, you look at copper, copper still going to be pretty depressed. You guys typically will buy ahead of it. I guess where were you locked in for copper for the second half of the year? And I guess, what are the kind of -- what are the offsets potentially to a copper tailwind in the second half of the year?

**Answer – Susan Carter:** Well, Joe, if you remember, we actually -- when we gave our original guidance for the year, we had actually planned on both copper and steel perhaps having less inflation in Q3 and Q4, and that's basically coming true. So if you think about copper specifically that you ask about, we're about 75% locked for the back half of the year, which is typical for us. Where you'll see the benefit of those spot rates on copper that really have come down is really in 2020, as I said. So we're doing buys every month for, whether it's for 2019 or for 2020. So you'll see the advantage of that appearing in the 2020 numbers.

And pretty much the same thing on steel. We know what we're paying for steel about 6 months in advance. And with either one of those commodities, the highest spot prices were in Q1. They started to come down in Q2, and they'll -- the spot rates that we see right now are down in Q3 and Q4. But again, that's more to our expectations. I don't expect that to be a huge tailwind in the back half of the year.

On the other hand, the good news is, is it's not actually a headwind like we've seen for the last couple of years. So like I say, we're taking advantage of it with our buying processes and with our supply chain each and every time we buy the commodities, but it actually is performing about like we expected and called for during the year.

**Answer – Operator:** Your next question comes from Andy Kaplowitz from Citi.

**Answer – Andrew Kaplowitz:** Mike, just following up on China HVAC. Last quarter, you basically were flattish in terms of order growth, and this quarter up modestly against tough comp, as you mentioned. -- last quarter generally demand improve throughout Q1. So did you see that improved demand level of at all in Q2 as other industrial companies are seeing a little bit or was it the second half of the year?

**Answer – Michael Lamach:** I would say in both climate and Industrial in March forward, bookings have steadily improved in China specifically, but the markets have shifted. As an example, electronics would be down, say, 15% as a market, but you will find other markets that have been compensating for that and some of the heavier industries that would have compensated. That steel would be an example there. Something that's -- or power generation, where there's a market both for industrial and for process cooling in those markets. So that's been good.

Yes, we’re stacking quarter 1 and quarter 2 of ’19 against plus 20s kinds of comps in quarter 1, 2 of ’18. So the stack in that is sort of still mid -- kind of low to mid-teens growth over the 2-year period. So we're happy with kind of what's going on in terms of the strategy there that we had around the direct sales force that we put in place, and then we're happy with the linkage, the service there. China is slower than it was historically, but still a pretty good market. And there's some focus not quite as strong as Europe around sustainability. But certainly, as I talked in the past, much more of focus in China around clean air and clean water. That's
Answer – Andrew Kaplowitz: That's helpful, Mike. Mike, you gave us a good clarity on PFS. But could you give us more color on how it's doing as it entered the Ingersoll Rand portfolio? Obviously, fair amount of industrial and obviously more oil and gas exposure there. So have you seen any slowdown in that business for your initial executions? It will be helpful if you could talk about how it's going in so far.

Answer – Michael Lamach: Yes. Let me start by saying, first of all, from cultural fit and from a performance mentality, from a goal deployment process, it feels like these guys have been here for years, which is fantastic, it's a great fit inside the company. In terms of achievement of their management plan, they are on track with that. So the mix has changed a little bit. You've seen it with some of the short cycle, like the rest of Ingersoll Rand, they've got counter measures how they're dealing with changes. So frankly, it's been positive. Sue, do you have any comment on that?

Answer – Susan Carter: Yes. It is actually a refreshing type of business because they do have several different brands that they operate under and several different end markets that they go to, and the management team is excellent at finding a real balance between the opportunities and the portfolio and the risks in the portfolio. And they are operating to the management plan that we use when we bought the business, which is great news, both revenue, operating income as well as cash flow.

Answer – Michael Lamach: And maybe just to give you 1 point on specificity here, positive bookings growth in the quarter against if you think about sort of all the fluid management peers are out there that I think are booking negative. We are really proud of that.

Answer – Operator: I will now turn the call over to Zac Nagle for closing comments.

Answer – Zac Nagle: I would like to thank everyone for joining us on today's call. And Shane and I will be available for questions over the next day or two and in the coming weeks. So if you're interested in having a call, please give us a call, and we'll schedule some time, and we look forward to seeing you soon on the road.