IngersollRand

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Nigel Coe: We're going to restart with Ingersoll Rand. Very pleased to have on stage Mike Lamach, Chairman and CEO, and Sue Carter, CFO. Mike, he being CEO for seven years. And I think all in, the stock price is up from $30 to $40 to I think $130, if you add back in Allegion. Congratulations. Good performance.

Why don't we just level load and think about, just give us one to two minutes in terms of (inaudible), and then we do Q&A.

Mike Lamach: It's seven and a half years, Nigel. Not that I'm counting, but I was joking with you; I kind of suddenly feel like the old man in industrial space in the office space.

Nigel Coe: You are.

Mike Lamach: The time's really flown. Really flown. I would start by saying that every time somebody asks me to talk about the future, the first thing I have to say to myself is that particularly for the last two or three years, I feel like the future's always been brighter in front of us as compared to any progress we made in the past. And it's absolutely 100% the truth. And as we go through our long range planning, as we start the annual operating planning processes, we see the opportunities in front of the company. Continue to feel that way.

It starts with the fact that we're in businesses that the thread that really connects the businesses have to do with a reduction in greenhouse gas emissions, a reduction in energy use. And even dealing with the tough problems associated with moving to renewable energy and how storage works and how that would relate to the businesses that we're in, create a really nice long, macro backdrop to being in businesses that will grow that have great service components to them, and we've been investing heavily in that. So, we feel really good about where that's going.

But the fundamental underpinnings is an operating system in the company that we feel like we've really have matured, continue to mature over time, that served us really well. That served us in weaker industrial, strong industrial, weak climate, strong climate markets, where we've been able to really put out a very consistent top quartile performance for organic growth, earnings per share, cash conversion, and total shareholder return.

When I look at that and look through the goals we went out through 2020, feel really good about that foundation, feel good about the macros and the investments we've made, and feel good about the probability being able to say, yes, we will be a top quartile earnings producer, we'll be smart, savvy allocators of cash and capital, and we'll be able to create value for investors over the next few years. And I really look at the next three years, and I am more excited than I am about the last seven and a half.

Nigel Coe: Great. When you think about what you've achieved in those seven and a half years, where do you think we are in the journey, the Ingersoll Rand journey, to best-in-class industrial? To see the performance has been very, very good, but where do you think we are?

Mike Lamach: Where we are is measureable in terms of we look at quartiles of performance and benchmarking. Where I want to think we always need to be is the perpetual fourth inning. We want to feel like we've done the heavy lifting around the operational foundational work, around strong management team and talk to the management team. But we want to make sure that we've got a pipeline of opportunities in the operating system that are more than what we need to deliver and what we're committing to shareholders. And so that to me is sort of that perpetual fourth inning.

But as you would relate to the benchmarking, top quartile growth, top quartile earnings, cash conversion, top quartile cash flow ROIC, top quartile total shareholder return. And yet, we look at it and say, we can get a lot better, margins can go higher. Certainly there's a lot of flexibility that we've got on our balance sheet to go deploy that in a way that creates value. So, all this can get better.

Nigel Coe: You obviously made a lot of changes to the management structure, the organization of the structure. And I think it's to be expected you put Dave Regnery as COO of the company.

Mike Lamach: EVP.

Nigel Coe: EVP.

Mike Lamach: We went from two to one.

Nigel Coe: Right. What's the thinking behind that move?

Mike Lamach: Didier and Robert both are retiring. Kind of a two and a half year view toward that. It's staggered a bit. Robert will retire in January and Didier probably in the fall, closer to the fall, which is a really nice way of overlapping that. And they'll be advisors to Dave and I going forward.

We've had really no turnover of management in the SBU's reporting to Robert and Didier himself. Five years ago, where the coaching and development and general managers across the company and their management teams was at one state of maturity; today it's at a whole different state of maturity. With Dave, we think that A) direct reports, and the ability maybe to look across the climate industrial segments, which we'll still report in, and be able to do even more sharing of what's going on between those segments is not only going to make us hopefully better, but it's more cost efficient really to move to the one EVP based on the maturity of our management team. That's how we ended up where we are today.

Nigel Coe: But do you think putting Dave in that position, you think it's going to drive more commonality on the back ends of those businesses?

Mike Lamach: I think the back end's interesting because Sue's leading a major G&A initiative across the company to get after that, and it's a lot of work on the functional teams to do that. I think where Dave can actually drive that would be more in the technologies, some of the industrial, and commercial overlap on heating, cooling, and air. And the ability -- so the way we've organized this is to even spend I think more time on some of the emerging economies where we've got a nice foothold, but to figure out what we need to be doing to continue to advance there.

We've done really a great job in the commercial HVAC business, Dave's old business, particularly in places like Europe where we've just gone from really nothing to something fairly substantial in a short period of time. With the right local product development management teams and product management, there's more that we could be doing in some of these other emerging markets, and I think Dave's well suited to do that.

Nigel Coe: Great. I do want to come to the G&A substory in a bit, too. I know you don't necessarily like to talk about intra-quarter trends, but maybe just give us a flavor in terms of what we're seeing in the major -- by segments: resi, commercial, HVAC, TK, and industrial.

Mike Lamach: You're right. We won't talk about intra-quarter trends. And if we did, it would certainly be confusing the with the hurricane and figuring out what the impacts are of all of that.

Nigel Coe: For sure.

Mike Lamach: But the trends that we talked about on the last earnings release where we would see institutional continue to pick up, to accelerate, to build backlog is still the case. The feeling that we would see a portion of the commercial business, the lighter unitary commercial business begin to slow in the back half of the year is certainly still our view. But relative changes in our transportation refrigeration portfolio with North America being a little stronger, Europe being a little bit weaker than we thought, that certainly is still our view.

And then with compressors, and particularly larger compressors, the backlog we've built in Asia, particularly in China, in the first couple of quarters bodes well for 2018. So, nothing fundamentally is changing from the quarter.

Nigel Coe: And I've been talking about the hurricane all morning. It's getting a little bit tedious. But maybe just talk about, because obviously it's very, very important markets, Texas and Florida. Maybe just talk about your view on how that develops.

Mike Lamach: First thing is we had about 2,000 people in the direct path of the storm, largest body of people that were in Puerto Rico. And unfortunately, we had a fatality of one of our employees in Puerto Rico, which is really when it hits home, and we also had another serious injury. So that was very sad for us. But once we know where all our people are and the news on them, you move forward.

And we had been planning for the hurricane, so in terms of supply chains in power, we were in good shape running our own operations. I think a more universal thing to think about is the ports. Jacksonville, Charleston, Houston, Savannah, particularly Jacksonville are going to be pressured for a bit. So how that will work out in the short run is really TBD.

And then as it relates to the business going forward, the negatives would be things that we intended to complete and bill and collect. You'd obviously not be able to do that in those markets. But the flip side of that is our rental fleets, which is a $100 million-plus business, was fully utilized in Houston and began to move to Florida. So that is a revenue driver.

We'll start to do a lot of building assessments, and having the largest HVAC service organization on the planet, certainly in North America, makes a difference in being us able to get down into these markets and be able to assess building quickly. Some buildings then will drive repairs, and those repairs, we're able to put resources into those markets for those repairs. For those that need to be retrofitted, it'll range between those that are mission critical and need to get going, and those that are going to fight insurance claims, which will probably nine months or a year that generally speaking, if you phase it out long enough, these tragedies create a whole different rev cycle around replacement that didn't exist. Much like Hurricane Sandy, which took a while to develop, these two will develop into having to rebuild the Houston and these economies in Florida.

Nigel Coe: I've very sorry to hear about the casualties. I wasn't aware of that. Just sticking with rev for a second, the last couple years you've been a clear share gainer in the market. Maybe just talk about what's driven those share gains and the ability of those share gains going forward.

Mike Lamach: There's been a long-term consistency around investment in the business. And one of the things we're proud of is the fact that we've done that with growing margins every year, substantially growing margins and investing in the business. And so what has been really a seven, eight year investment journey started to really pay dividends for us. Particularly in the HVAC space in 2013 and 2014, it's continued through. We think it'll pay dividends and has already in some of the compressors that we've dealt on the industrial space in that period of time.

If we keep driving toward the Holy Grail being energy efficiency and lower greenhouse gas emissions, we're on really solid ground. And when you think about the big equipment we sell, whether it's industrial or HVAC, 10% of what the cost of ownership is is the initial price you pay. Other 90% of that is the energy it consumes and the maintenance it requires. And so long as we're the basis of design, and/or we have the opportunity to talk to a customer about that total cost of ownership, these differences in efficiency, these differences in maintenance, and these digital capabilities that go across all that create an opportunity to sell more value. And that's been a driver of our margin expansion for us as well.

We look forward to the next few years. We try to program out all the roadmaps, whether they're product or services or channel, and look at the investments required and the returns on those. There's still lots of opportunity we see to improve on efficiency, to improve on the emissions, and to improve on the channel presence. I don't think -- again, this goes back to my initial comment. I go through 2020, and I'm really excited about the future. I think that those are better days than even the past.

Nigel Coe: And you're piloting and launching the Trane GO portal to take leads directly to dealers. Maybe just talk about how that's tracking.

Mike Lamach: Trane GO is a broad digital offering to the consumer. What we did is we talked to literally thousands of consumers over a long period of time, and we realized that if you talk about a HVAC brand in North America, and you want to know what the unaided awareness is of the Trane brand, it's about one third, or double the next brand in the marketplace, which is about double our share in the marketplace. And so what we see from that opportunity is how do we close that gap around that entitlement.

The number one thing that stops consumers from moving forward with anybody is this feeling of lack of transparency in the market. And so we worked with consumers to figure out what sort of a reasonable installed cost range would be based on their zip code and location, and we simultaneously worked with our dealer base to figure out, are these give you enough room to operate within the conditions of the home to be able to install these systems? So we found is that we could get a match nearly in every zip code and every dealer to be able to put that together.

And when you put that together, what you're doing is you're giving the homeowner total transparency about what the installed cost range should be for a range of different efficiency options, and you can calculate paybacks from that. When the dealer shows up, not only is the customer comfortable with the range, but the dealer's comfortable with the range, and they were able to set up that meeting online. And we're able to do a little bit of Match.com in the background around getting the right dealer to the right consumer. And we're able to do a lot of I would say Yelping at the backend of the deal to make sure that the consumer experience and the dealer experience were positive.

And so transparency is going to come at everything we do. It's going to come to HVAC residential. We think it's an opportunity to close that gap between share of brand recognition and actual share, and we think it's good to be a leader in that.

Nigel Coe: I think that's the first time we've heard Match.com on stage today.

Mike Lamach: Yep.

Nigel Coe: Non-resi, obviously there's the slowdown pieces out there. You talked about institutional offsetting a slowdown. Couple questions here. One is have you seen a slowdown in light commercial, and if so, in which markets? And then secondly, what's the math that gets you confident that institutional can offset any softness?

Mike Lamach: Light commercial is the least predictable thing that we could possibly be trying to forecast. But ironically, the best data point that seems to correlate that with an incredibly high R-squared is new automotive sales, which is a six-month lag. When that starts to dip, you start to see light unitary dip six months later. So we're into that dip, and that was what gave us confidence to say the next quarter three and quarter four are going to show lower light unitary.

Light unitary is really a $200-ish million business for us and the company, and it's really defined by tonnages accruing between 5 and 25 tons. So think of where a home unit stops at 5 tons. Light commercial stops at 25 tons. It's going to be things like fast food retail or light office building, strip malls, those sorts of things, that'll begin to slow.

Conversely, on the applied side, the institutional side, this is where there's a specification. You're working with the consulting engineers, you're working with the owners. To get it even to a spec, you're bidding on the project, the specification. You're being awarded the contract. It's being delivered 6 to 18 months into the future, and you can really build a pretty consistent pipeline and backlog around that. A combination of these two things where light commercial comes down, much of larger unitary commercial continues. These are data centers or K through 12 schools, so they continue. And then applied has got a nice backlog and a nice pipeline.

So what the net of that is we feel like 2017 is predictable in the whole, and we think that 2018 is beginning to take shape into a plan where we should see, again, growth in 2018 led by institutional, led by larger unitary, and then a slowing light commercial.

Nigel Coe: What's the roadmap or the outlook for Europe and Asia?

Mike Lamach: Europe is totally different for us. Europe, I would say we reenter the market after decades of not really being that present in the market, not having a refrigerant that was accepted into many parts of the market. And so what we've been able to do is just look at the market, irrespective of the growth rates, and say, there's a real opportunity here for us. And we're seeing that in terms of share growth and overall growth inside the business that it doesn't really matter what the overall economy is doing. Now the overall economy is not bad, by the way, which doesn't hurt things, again. But just by virtue us being present in the market with the most efficient light refrigerants for the market, and then other channel characteristics that we have invested in, puts us in a really great spot for the future.

Asia, we've always had a really good spot. We've never really played in residential. It's always been in commercial. And we're seeing good bookings, good growth rates there. We're seeing that also in big air compressors in our industrial markets as well.

Nigel Coe: Okay, that brings me next onto industrial. You mentioned Asia, that you've seen some recovery in activity there. But where else are you going to see the recovery in your industrial air markets?

Mike Lamach: Well, a little bit like the Europe conversation, we've put a lot of investment into a couple of technologies that are in the midsize compressors. One is an oil-free offering, and the second is really a oil-flooded, or what's called contact cooled offering, in the middle of the product range. And we've launched those with dramatic efficiency improvements, both to our old product and to the market. So here, much like Europe, it's a matter of being able to penetrate a market with a much more competitively efficient product that I think will help us grow there. Where we've launched those products, we've seen good progress, good results around margin and share gain.

Nigel Coe: Great. Maybe we'll pause there and see if there's any questions in the audience. There's a mic floating around here. Any questions?

Unidentified Participant: Thanks. Just wondering if you guys can talk a little bit about your intelligent building opportunity and some of the investments you've made in regards to your digital strategy. I think you laid it out back in May that you had a pretty robust base of connected buildings, and so just wanted to get your thoughts on how you're thinking what the incremental opportunity there into 2018 and 2019.

Mike Lamach: The digital offerings across the company are really present not only in HVAC, but the same conversation around industrial air, around Thermo King and telematics, and around Club Car and telematics. It's a very interesting proposition because it's always difficult to say exactly what is digital doing for your bottom line. But I can tell you that the tip of the iceberg is when we're able to take an offering and actually sell it to the customer as a subscription or as a service.

But 90% of the benefit of what we're seeing is the ability to take information coming off buildings or units or golf cars and feed it back into either new technology, or enhancements to the current product, or to the way that we deliver services, whether to a building and through a TK unit that's rolling down the road, or to a gold cart that doesn't really matter, or through a compressor. And all the way through to the ability to offer service offerings that you are really in real-time control of the building and selling more of an outcome.

By that I mean the opportunity to take a building that we've modeled to have a certain energy efficiency or energy usage, think about that as a birth certificate for the building. The ability to continuously commission that building remotely, and when necessary, through deploying people to go support the building, is an offer you can sell on its own, it's an offering that you can bundle with guarantees like energy efficiency or building equipment uptime. And lots and lots of different ways where it's now possible to shift some of that risk onto us, and have us understand that risk profile so well that we're confident about being able to deliver a service of higher margin. So, this is a real deal. It's playing out across the universe of the value stream, and it's playing out across most of our product portfolio.

And linking these things to, we use the example of a point of sale system in a theater was the example we used at the conference. Where if you think about a theater, you don't know if 10 people are going to show up or 100 people are going to show up for the theater. The ability to understand how many tickets were sold, and then understand what the demand is going to be for cooling, and then condition that space optimally for those folks is a multi-million dollar proposition for a theater chain, example there.

Schools, where budget certainty is critical for them, where we're modeling buildings and school districts so tightly, we're able to see if the gymnasium was used on a Tuesday night. And if it was, is that a permanent change of use or was that a one-time change of use? And that's certainty that you couldn't have had in the past in those markets.

The ability to then deliver a service in a tight employment market with skilled trades that are tightening more and more, the ability to leverage that technology and to how you deploy service is a big idea. So technicians today in pilots that we have, that are out with Google Glass, inspecting systems, giving proposals, sending the video and a proposal to the customer, getting the order for the fix. Sending out somebody who might be a 5-year technician with a 30-year technician managing four service engagements at a time, instructing somebody on what to do, how to do it. Sending the customer along with the bill, the video of the work that's been done, collecting that faster. Those are all things that are actually happening today that wouldn't have been happening two years ago. And those investments are important to grow the company, to grow margins, and to deal with real issues like labor shortages and skilled trades.

Nigel Coe: Great answer. Anything else? Okay. Not looking for 2018 guidance here, but just looking for some help in terms of modeling 2018. Two areas where I have a problem right now is Thermo King. What are the puts and takes we should think about for next year for TK? And then secondly, price cost. Obviously with copper, aluminum, steel from the grind are a little bit higher as well, so how should we think about those four over the next year?

Mike Lamach: Price cost, let's do that one first. If you go back and look at a cycle between 2010 and 2013, you had more predictable rising material costs. The industry, and certainly we, were able to recover against that material inflation. When we were pricing 2014 and 2015 for 2016 deliveries, we priced in inflation there, we got deflation. We had 110 basis points in 2016 of positive spread.

In 2017, you had a little bit of speculation in aluminum and copper, a little bit of noise around regulations in steel that drove something up faster than the pricing on the long lead equipment would have given us visibility to. They're going to be 40, 50 basis points upside down, but net of the couple years is about 70 basis points right side up.

I think that what you'll find is that if you go into 2018 and it's an inflationary environment, but it's a more predictable, say less speculative environment around the commodities, you'll find the industry, you'll finding us pricing to cover that material inflation going forward. So, it's nothing really structural. It's just a matter of how fast things happen relative to commitments that you've already made.

And we get the question, well, why don't you put bands around that with customers? Well honestly, it's an advantage to be able to price into the market and then manage our commodities separately from that. There's probably more, it's a bit asymmetric. There's more upside than downside by leaving it uncollared. Unfortunately, you go through little periods like this where you're upside down.

Sue Carter: I think I'd add to that too is when we look at 2018 -- and mind you, we're not ready to give guidance on this -- but our operating system is going to have us managing the entire P&L. Which means that if we've got material inflation, we need more productivity, whether that's on the material side, whether that's on the SG&A side or where it's at in the business. So, if you manage all of those different pieces with the idea that you're going to have top quartile revenue, you're going to continue to invest in the business, you're going to grow operating margins, and you're going to grow cash flow, I think you end up in the right place.

One of the other things we talked a lot about today, Nigel, that doesn't really come out in our discussion on price cost is that we actually have really good material productivity in the business that we don't include anywhere in that price cost equation. We just include that in our regular productivity numbers. And that's actually a really good metric for us that has been a significant contribution to earnings over the last several years. So like I say, I think the key is managing the entire P&L, managing all of the different levers, and making sure that we're continuing to grow.

Mike Lamach: As long as we got productivity, we've only got over a 12-month period by things like direct material/ indirect material, direct labor/indirect labor, other productivity ideas in the company. And so when we see that you're going to have a hole of a pricing mismatch around material inflation like we had in quarter one or quarter two, we were able to really understand that, isolate that, and drive higher productivity for the first half of the year. Still get margin expansion, net of the 40 or 50 basis point reversal. So, it's really important.

Again, when I talk about operating system, it's a system to look at all the levers, and to have a plan for every lever at all times that rolls every 12 months. We try to get 125% of whatever we think we need to do in any of those levers so that we can provide for timing differences, or the impact wasn't what we thought it would be, or we just discontinue a project, if we're able to have enough in there. And we measure the health of the pipeline as to how we're doing at 125% of the target, and we do that by month and by quarter. So quite a mature system inside the company where all of these thousands of projects roll into a piece of software called Windchill that really gives us that sort of basis.

Nigel Coe: And TK's (inaudible) answer that question?

Mike Lamach: TK, I keep saying it's a resilient business. If you think about last year, revenues were down, margins were up. You think about this year, revenues flat/down, margins sort of flat to the prior year. And think about trailers where we thought dropping and we thought there was an opportunity for auxiliary power units. Well, the strategy of getting auxiliary power units onto non-refrigerated tractors where we had 13% penetration, and we had 70% penetration on refrigerated trailers, there's no reason it's the same tractor. We've been able to move that 13% to 18% over the last couple of quarters. Every 2.3 auxiliary power units equals one trailer unit. And our people think like that. They're really thinking about the six or seven businesses that TK's actually in to support something that's not maybe moving in the right direction. So [Act] has 2018, Sue, down around--?

Sue Carter: Actually, it goes from 42,000 units in 2017 to 39,000 in 2018.

Mike Lamach: So not quite a 10% drop. And we would think about that as what are we doing with, auxiliary power units, what are we doing with truck? What are we doing with air, with marine, with aftermarket services, with telematics to fleets, and so on and so forth. But I think we can handle these product line blips in a way like we handled 2016 to 2017, and continue to run a really solid, high margin business through that. It's very different than what it would have been 5, 10 years ago where it was very trailer dependent.

Nigel Coe: Okay, great. We're getting a bit close to the end here, but I do want to touch on two things with Sue. One is the $1.5 billion placeholder you've got in place for capital allocation this year. Your degree of confidence in getting that done by year end. And then how you think about M&A between now and year end.

Sue Carter: The $1.5 billion that we put out for combination of share buyback and M&A, in our second quarter call, we talked about M&A being in the $300 million to $500 million range, with that pushing more towards the $500 million range and then the remainder being share repurchase. So, we've committed that for the year and will execute on that. I think another important part of that, though, is in addition to the $1.5 billion, we also had committed $420 million to the dividend. And of course we're executing on that, and it will be slightly higher because we raised the dividend by 12% in August.

So what I would say on that, Nigel, is we'll follow through with the capital allocation strategy, but we always want people to understand that that's a dynamic strategy, and it won't look like 2017 every year. We're going to do the best things for the business, but we will invest in the business. We'll have a dividend that grows at greater than or equal to our earnings profile. We want to add M&A, and at a minimum, we'll do share repurchase to offset dilution.

Nigel Coe: Got it.

Mike Lamach: The cash flow ROIC has been another one of those top quartile metrics that we've been 18-plus% last year, 23% cash flow ROIC. We delivered cash at an income above 100%, pretty much on average the last five-plus years. The quality of earnings is very high, and so the predictability of having the cash deployed is good. Sue's point's exactly right. Want to be dynamic about that, whether it's in terms of buying the stock, we'll do that. Whether that's a better option than M&A where we'll do that and vice versa.

Nigel Coe: I wouldn't normally want to touch on G&A, but I think it's an important part of the story. So maybe, Sue, just touch on the opportunity there.

Sue Carter: We're doing a project across the company in G&A. And what we're doing is we've done some benchmarking. And the unique part about what Ingersoll Rand is doing is that we benchmarked all of the functions at the same time. What we're doing is we're bringing our value streams and our operational excellence programs into G&A with the idea that we are going to grow G&A at a lower rate than what our revenue's growing, so adding to the leverage of the company.

And so this is actually quite a process. It should bear some really good results for us as a company through doing things better and easier using robotic process automation, using good, lean processes throughout the functions and making that right. But it'll actually contribute a great deal to the operations and the growth of operating income over time.

Mike Lamach: Overall, we're middle of the pack, Nigel, on that G&A. And if you think about quartile targeting, this is a pretty nice opportunity there for margin expansion.

Nigel Coe: Got it. I [see a mic], Mike. I think that means we're out of time, so, [so long].

Sue Carter: Thank you.