Ingersoll Rand

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Mike: Thanks for having us back again.

[laughter]

Mike: Sue and I are delighted to be here. Just to spend a couple of minutes. I'm entering my ninth year as CEO. I'll tell you, I'm more optimistic today than I would have been at the beginning, and there's three fundamental reasons. First one is, all the work we've done on our operating system throughout the years has really paid off.

Things like cash flow, ROIC, the last seven or so years have been in the top quartile, incremental margin's top quartile against growth. Cash in general has been strong for us. Second, very stable, very strong management team, with great bench strength.

Third, it's the first time I can remember in a long time that when I look across the world, and look across our businesses, we've got things growing at the same time, that's phenomenal. From a macro perspective, strategically, when you think about our company, the most important strategic driver that we see is around sustainability, energy reduction, greenhouse gas emissions globally.

That drives a large part of the company. HVAC can be 40 percent of the greenhouse gas emissions in a country, in a building. Buildings are going to maintain...40 percent of that is going to be HVAC. When you think about greenhouse gas emissions, the impact in buildings, I could make the same argument around industrial processes like air compressors or even our Thermo King transport business.

We're being paid to innovate around greenhouse gas emission reduction, around energy efficiency, and being paid for that. The businesses that we have today are businesses that truly can be differentiated through innovation. We've invested heavily in innovation over the years and we'll continue to do so into the future.

That is the foundation strategically. I'll talk a lot about the operating system in a company. It's really what guides us to continuously improve in what we do. It's based on a lean foundation. That is core to the operations and how we run the company day to day.

May get a lot of questions to you, but I would just say, as we think about coming off the fourth quarter and starting the year, there was a lot of momentum coming off quarter four in terms of bookings. Markets continue to be very strong for us.

We expect to drive mid-single-digit, top-line growth in both segments. We expect to see solid leverage. It should look about like our gross margins, incrementally for the year. We are a strong cast generator. Don't expect that to change in 2018. We've been a rigorous deployer of capital. Review here has been toward fully investing in the business and high ROI projects.

After that, certainly, it's been around maintaining a dividend in the 35 to 40 percent of free cash flow, and growing that at least at the rate of net income. It's about making sure that we at least control a dilution in the share account, and then move between share buyback and M&A as to the best use to drive, greater shareholder returns after that. With that, Steve, I'll open it up to questions you have.

Steve: Great. You talked about the momentum coming out of the fourth quarter. So far, the indicators in industrial, as well as some of the HVAC guys, have been pretty bullish on what they're seeing so far this year on demand.

Maybe if you could just at a high-level talk about a few of the businesses from a top-line perspective, bookings, and how you're seeing things play out? It seems like things are a little bit better than expected for most that we've heard from at this conference.

Mike: The starting point, the most important thing to think about is when we laid out guidance for the full-year EPS, we think we're right on track with a line of sight to go deliver that. Obviously, the pieces inside the P&L are going to move quite a bit, as they do in any given year.

Starting at the top line, it's difficult to find a region of the world or a business right now that wouldn't be growing across the portfolio. Again, this is the unusual part about what we've seen in the portfolio. I can't talk to you about a business unit that's not growing. I can't talk about a region of the world that's not showing progress this year.

Clearly, a big part of the company's portfolio is in North America. On the HVAC side, both residential and commercial, we see strong growth trends continuing there. Industrial began to pick up on the short cycle stuff in 2017. We began to see in the fourth quarter some of the large compressors pick up in '18. That bodes well for us in terms of the leverage that we see off larger compressors, as well.

Thermo King, I've talked in the past about being a diverse business. It really is a diverse business. It looks like we're seeing a little stronger North American trailer business than we would have anticipated. ACT just took their numbers up to around 41,000. We would have been in the 38,500 range for that, so that's a positive. We get a lot of questions, usually from shareholders, about that.

In terms of the other smaller industrial businesses, really good demand there as well, in both material handling tools or fluid management business, and in some of the book-in-turn smaller compressors.

Steve: On the commercial HVAC front, orders here can be a bit lumpy. They've been pretty good. Are we settling into more some double-digit type of quarters?

Do the kind of comps matter here going forward? Can we sustain this kind of high single digit type of booking range, or are we settling into more of a mid-single digit type of environment on the commercial front?

Mike: Until you get through the April through August time frame, it's really difficult to tell exactly what's going to happen in terms of bookings. Strong fourth quarter, looking good for the first bit of, or the first quarter for sure, we're seeing a growth continuing there.

There's a certain elevated, mid-single-digit growth expectation we have around the commercial and residential HVAC markets. The lumpiness is only in the larger projects that we come on top of that. We're seeing a higher degree of larger performance contracts or larger institutional projects that, if awarded, would certainly change the numbers on the up side.

Steve: I'm just going to skip all the questions on raw materials so we can move right to cap allocation.

Mike: [laughs]

Steve: Just on priced costs -- obviously, a very big topic. Lennox was here earlier in the week talking about they're going to see bigger commodity impact, but with their residential business they feel very comfortable they're going to put price through. JCI made somewhat similar comments, maybe a little bit more cautious because they're a little more on the high-end applied area.

What are you guys seeing out there? What is your ability to mitigate what's coming down the pipe, either today or post the tariff discussion? Maybe just help frame it for us.

Mike: In terms of the part of our portfolio that is the book-in-turn, the stock businesses, like residential HVAC as an example, you're able to put a price increase out. Typically, the industry recovers on average about half of the price increase.

There's plenty of head room to work inside the price increases that we've given. To the extent that we would need to put a adder on top of that, there's opportunities to be able to do that as well. These book-in-turn businesses generally do a nice job of being able to recover material inflation over time. They do a good job of being able to hold on to that price over the long haul.

The longer-leads equipment that we would be booking, fundamentally what you have to do is have an assumption around what's happening with commodities and then a series of iterations and pricing in the marketplace to understand that the competition sees that the same way.

When you come to aluminum and steel in particular, you've got to first separate, I think, tariffs from what's going to happen with price increases, and separate steel from aluminum too. Let's just take tariffs for a second. On steel as an example, 99 and a half percent of the steel we buy is in the US for US production, so tariffs don't really applying the steel side of things.

In the aluminum world, only about 15 percent of the US aluminum demand is handled by US suppliers. Even if US aluminum production were to double or triple, it's probably going to be about 50 percent or less of what the actual aluminum demand is going to be.

Here you can think about an aluminum producer either ramping up idle capacity. You have to ask, is that going to be efficient capacity or how long will it take to bring out new, more efficient capacity? It could take a while.

One thing for certain is I would see aluminum prices moving up toward the tariff amount. You'd probably see new parity of pricing around that tariff amount. Anyway, a slice of the US is going to be a large importer of aluminum. That's going to apply throughout Industry for us as well.

I think aluminum, you can kind of see the writing on the wall there. You're already seeing the Midwest adder, five to eight percent adder just on the volatility of what could happen there with aluminum. Steel's a bit more difficult to predict in terms of what the long-term pricing could be. It could be as high as that tariff coming in into the country.

Here we've got about six months, four in view, in other words, that we've got steel pricing from our suppliers lags three months and usually three months of inventory. You've got six months of steel that you know the price. For that book-in-turn there's not much risk there.

For the long-lead stuff, again, you're having to pick a number out into the future. You're about to guess on where that'll go and price that in and make sure competitively it's being reflected by other competitors.

Steve: That's great color, because a lot of management teams will gloss over all that. That really is an informative answer. When you look at the part of your business that is more of the longer lead time -- book today, deliver 6 to 12 months down the road -- how big is that?

Then I guess you'd have to think about annually, how big is that number that you're maybe -- I don't want to use the term exposed, but -- exposed on?

Mike: If you actually take a real-live example and take aluminum and you think about aluminum going up 10 percent immediately, what would the impact of aluminum going up 10 percent be on our company? In terms of tier one raw material bought, about four million dollars. In terms of tier two, it's about four million dollars.

Only about eight million dollars of aluminum that we'd have to overcome in terms of pricing. Confident that since we know where that's going to, we can price that. Again, steel would be the more difficult piece of that. When we were talking earlier, Steve, we were talking something in the order of maybe $1.5 billion of large equipment priced out beyond six months in terms of delivery.

That's probably the magnitude of what the risk is. Again, we're going to be pricing around an inflationary environment, and thinking through that as we go. Again, if, in fact, there is a 25 or higher percent movement in steel prices. That's something probably the industry's not going to price in today, but the industry's definitely going to be layering in additional steel pricing over time.

Steve: When you think about your plus/minus 30 BPS of price cost for '18, is it too short of a time period to influence that range? It sounds to me like there is risk to that range.

Can you still be within that range, but below or in the negative 30? Does your backlog just hit you to the point where it's going to be worse than that, and you've got to pull additional levers to make the all-in P&L come to where guidance is?

Mike: I'm going to answer your specific question. I also want to answer a bigger question, too, which is, the guidance we gave around EPS is guidance that we absolutely have a line of sight to delivering that, even though the 232 economic shock happened after the guidance, because we're managing an entire P&L, and there's going to be puts and takes.

I always use the analogy of a boxer steps into the ring with a flight plan until they get punched in the nose, and then they learn how to fight the additional rounds. What we're seeing in the first couple of rounds here is markets are good, maybe a little bit better than we've thought.

Pricing is good. It's about what we thought. Internal inflation, probably going to be more than what we thought as it relates to what's happening with 232. Net it all out with good cost control everywhere else, and we're on track for where we need to be in terms of our full-year guidance.

There's a little bit of volatility here in the short run. The range specifically around that one element of price material cost of the plus 30, minus 30, you're certainly initially going to be challenged on the front part of the year as we try to absorb what those increases might be, and how to program those in in terms of recovery.

I don't think it changes the overall equation about how we get to a solid commitment on the earnings number that we gave a couple of months ago.

Steve: This sounds like it is possibly below that negative 30, but again, you're confident with the EPS range, and you mentioned P&L?

Mike: The full-year range is a good range. It puts more pressure on the first part of the year than it would have been when we gave guidance.

Steve: When you think about the offsets to that, we were joking earlier that it's hopefully not tax or something like that. Is this a point where you use the balance sheet to offset, so, "Hey, you know what we've got. We could do a couple hundred million of buyback and get an extra five cents?"

When you say P&L, is that blocking and tackling on cost and stuff that's above the operating line, including corporate? Or is it, "Hey, we're going to work the balance sheet a little bit, and kind of offset."?

Mike: The line of sight we have is an operational line of sight about really hitting that number. The balance sheet optionality depends on how we spend the capital. Again, if we were to do more buyback earlier in the year, it would certainly impact that as opposed to late in the year.

We're still obviously working through that balance trade-off between M&A and buyback. We trade a fair bit below what we believe the intrinsic value is. That's always a challenge as you think about the immediate opportunity in the share buyback versus what we're seeing from an M&A perspective.

From an M&A perspective, there's a lot of channel and technology ideas. We did 17 of them last year. They were small in nature, very high ROI type investments for us. Those are no-brainers in that regard. Of course, there's some larger consolidations that could play out there.

What you're seeing inside of that mid-market, $500 to two and a half billion dollar range, in our estimation is still elevated expectations around value. Sometimes the scale is not quite what you need from a synergy perspective to have it really work. As long as we're trading at a discount to what we believe intrinsic value is, we're always going to be making that better choice in real time.

Each quarter, we're committed to pulling the capital, pulling the cash. Certainly, each quarter that we're not really making a move, we'll spend more towards share buybacks, as long as that intrinsic value dynamic still is in place.

Steve: That makes a lot of sense. That's the challenge when you look at, I don't think you are necessarily getting the credit for the business and what you guys have done.

It's tough to go in a high multiple acquisition environment when you're trading at a 20 percent discount to the group, and go do something that's really accretive. That's a bit of a challenge, unless you work the portfolio a little bit, which I'll get to in a second.

Just to round out this conversation on price costs, I think it'd be helpful. What are the few businesses that you would highlight? We talked about the large unitary. Maybe just the three buckets of revenue that have to be worked from a backlog perspective, from a long lead time orders perspective?

Mike: Typically, the kinds of things that we would book and ship outside a six-month window are going to be compressors. That would be the larger oil-free technology, and the larger centrifugal engineered order machines that could go as long as 18 months. That's one piece of that.

The second piece would be the larger applied, specifically chillers, and some of the custom air handling units that we do for specialized facilities are often 6 to 18 months in terms of the cycle there. It extends down a little bit into how we think about the larger unitary HVAC market. You have to recognize that when we say large unitary, a lot of our competitors have already stopped making unitaries.

When we say large, we're talking about, in nominal tons, 75 tons, which is a very, very large rooftop unit, maybe half the size of this room. That would be a long lead item going up in that sort of space.

All in all, when we total that together, your estimation of about one and a half billion dollars for now is a pretty good estimation about probably what that is. Raw material content is about 10 percent, and about 10 percent more would be that pass through two tier piece. You're really adjusting with that dynamic in the background.

Remember, too, that billion and a half, there were already price increases programmed in. It's really only the incremental that we're talking about.

Steve: Got it. On that front, on the commercial side, a lot of noise from your competitors after being pretty quiet for several years. You guys are way out in front of these guys in refreshing your chiller line platform.

Carrier's been out with theirs. York came out with the YZ platform. What are you seeing as those guys try and burrow their way back into the market that you guys have been out in front of? Are you seeing any irrational behavior with their trying to rebuild the installed base?

Mike: The first part of your question, there's a lot of technology, and then technology challenges and IP challenges when you're not first. There's an advantage here that is playing out in that front, as some of our competitors would learn some of the issues associated with trying to adapt to the technology.

The technology fundamentally, to make it simple, is how do you take 99 percent of the greenhouse gas emissions down using refrigerants that are less efficient, yet have a system at the end of the day that's more efficient than the predecessor?

The holy grail is, whenever you go to a more energy environmentally friendly refrigerant, the natural efficiencies go down. How do you then make the system more efficient in total? That's what we were able to produce, and that's why it's been a good story for us. We need to continue to do that. No matter where people are in the catch-up process, we're thinking about how to go beyond that.

As just an example, technology that we're reviewing this week, we're able to take compressor efficiencies which we lead the industry in today, with the correct refrigerants, and get another 10 percent bump in efficiencies going forward.

If you can compete with one or two percent better efficiencies over the 30-year life of these projects, and just to digress for one minute, only 10 percent of the total cost of ownership is the equipment itself. 90 percent of it is the energy use and the maintenance on that.

A one or two percent efficiency difference in a commercial application or air compressor is an enormous advantage over the 30-year life of the system. If we can get a 10 percent improvement in efficiencies, so the passion and the energy of the company is really around compressor efficiencies, controls, motors and drives, and how that comes together in systems. The technical differentiation there is critically important.

How people react to that, if only 10 percent of the total cost of ownership is the price, you can get a premium around that total cost of ownership as long as the efficiencies and the maintenance are better. If you wrap around that value proposition a service guarantee that says, "It will be better, and/or we'll replace the system, and/or we'll make up the energy shortfall."

It makes it very difficult for a competitor to say, "Don't believe their efficiencies." If we're willing to guarantee it, you're going to get customers taking you up on the value proposition.

Steve: How have those guarantees worked out? There are other companies in my sector who have seemingly given guarantees that they weren't so transparent about, and it's come back to bite them a little bit. How far out on a limb are you going on these guarantees? I would think a chiller sitting in a building is not like maybe some other products.

Mike: It starts with the fact that for over 30 years, we've had the industry standard building modeling software. All of what we do really is an iteration of that software, which is not just the HVAC system, but it's the building, the shell, the insulation, the roofing, the glazing, the lighting, how it all comes together in a building.

That model is something that's refined now to a point where it's extremely accurate. Then the fact that we can digitally overlay the performance of a building against that digital twin when the building was born, you're always able to keep your actual results, the system with the modeled results.

Steve: You guys have been doing this for how long? How long have you...?

Mike: This part around the digital twin, the modeling, that aspect is a few years, 30 years on the modeling, and probably 15 years on the performance contracting aspect of it. The whole digitalization of that's given us more assurance, more real-time management on a minute-by-minute, day-by-day basis, to be able to manage the guarantees that we give. That's a very powerful value prop.

Steve: For you guys, too. You can price with confidence. What you're saying is that 10 percent first cost is not necessarily who you're going to get in the mud with. You're focused on the TC of that?

Mike: We want to cover the market. We want to price the market. When we're out there creating demand and looking for opportunities, we're segmenting that in a way that plays to that total value prop.

Steve: Are you seeing these guys come in with a little more of an aggressive first cost proposition to get these platforms off the ground in the end?

Mike: When you're growing a lot of share, you're going to see competitors trying to fill the factories. Ultimately, you deal with competitors that are trying to deal with backlog margin problems. That dynamic, if you just wait long enough, tends to play itself out. We've got great competitors, but it goes in a bit of a cycle.

If you're gaining share, or if you're on the losing side of that, you tend to price more aggressively. You tend to price more aggressively back when margins go down. You either price more or less aggressively, and that sort of a cycle is happening a little bit, too.

Steve: We'll ask Carrier tomorrow, and I'll let you know what they have to say. They're having their investor day tomorrow, actually, so tune into that one. On the portfolio, you guys have done a great job generating cash, and you haven't extended yourself from a leverage perspective. You're sitting in a nice seat here with some capital to deploy.

In one of the earlier meetings, there was a question around HVAC industry consolidation. There's five players out there. A lot of them are talking about portfolio moves. What is your role in the HVAC industry? How satisfied are you with the current portfolio? Where could you see yourself in the future?

Mike: There's 15 players out there that are names that if I rattle them, you'd recognize most of the names, 15 of them.

Steve: The Global guys, the BRF guys. Sure.

Mike: My philosophy in this is it's probably three to five winners at the end of the day of various capabilities and scales. Some might even have a little bit different business model around that. That's certainly what's playing out, is discussions that that consolidation might happen.

We have a full product portfolio. We've got that portfolio all over the world. Our model has been to have great, efficient, and environmentally friendly equipment matched with controls, have a service organization that's company owned and delivered. Then put a digital overlay across all of that to improve performance or sell additional value to customers, a combination of all of that.

That's been our business model. We don't have any holes in the business model, but certainly, scale could be an advantage. There could be advantage in various technologies and niches that could come together on that. We're always looking at what the combinations might be that could help solidify the portfolio going forward.

Steve: When people talk about HVAC consolidation, we should step back and not just think the big four or five here in the US. You're thinking about it in more of a global sense?

Mike: When I said five, I was already outside of the US.

Steve: Got it.

Mike: I don't even think about it as a North American business. It's three to five global competitors, and the five today are already global competitors.

Steve: Is there anything big out there, or are these mostly, "Hey, we're going to buy 500 million here, a billion there?" Maybe talk about what's in the pipeline and the flavor of the stuff, small, the medium, 500 million to two billion, and then the large.

Mike: Last year, we had 17 deals. A lot of these wouldn't hit the radar screens of investors or materiality requirements, as we go through that. A lot of that activity is around channel, and around specific technologies that we think are really exciting, that we can lay into the channel or lay into the product portfolio, really high ROIC stuff.

We're trying to generate more and more of that, and be much more outwardly looking at those technologies wherever they're available. You're seeing acquisitions and partnerships around that on the front end. It's a lot of activity. 80 percent of the volume of ideas is down there, though it might be 10 percent of the capital being spent. Of course, we've got industry consolidation on the other side of things.

The more difficult place to find value between 500 and two and a half billion, between expectations of sellers, between some of the scale involved, which may not be overwhelming in terms of what that can do for you, and then again, come back to the original intrinsic value of the share price. That's generally been where it's been more difficult for us to find good value.

Steve: The 500 million to two and a half billion, is that in value, or is that a sales base you're talking about?

Mike: Value.

Steve: On the flip side, you still have some discrete business lines. You have the HVAC stuff. You have Thermo King, and then you have industrial. There are varying degrees of synergies there.

Given your stubborn discount, would you take another bite at the apple here as far as doing something more dramatic with the portfolio if this discount sustains itself? It would seem on some of the parts that there is some nice opportunity with you guys.

Mike: What investors really need to understand is that, first of all, you want to create value, however much you can create that. The thing that we really continue to bring investors back to is we're in the compressor business.

These energy efficiencies and this greenhouse gas emissions discussion happens across the entire HVAC portfolio, and a large portion of the industrial compressor portfolio. The exact same technology, centrifugal [inaudible] , rotary, screw, reciprocating, compressors.

We make about 80 percent of our compressors for our own use. The 20 percent that we buy, we buy more of the commodity variety, and have the ability to make those ourselves if we don't like the pricing on the commodity version of that. When you pull apart that compressor synergy, what are the components?

The components are all the engineering is shared. The manufacturing and machining is shared. The sourcing of the same casting motors, controls, drive suppliers that we would use. It's about $150 million headwind, so you'd have to have a value gap that would be sustainable of at least that to make it make sense in our mind.

Steve: That's not such a big number on your market cap.

Mike: Eventually, at the end of the day, 20 percent cash flow ROIC is going to catch investors' attention, and the fact that we've given back to investors...

Sue: Six billion dollars on just share repurchase since 2011.

Mike: That's going to catch up in terms of the valuation. We really have been compounding cash here, and it's a great thing. That's going to catch itself up on that front.

It doesn't take away from the fact that the synergies are real. What it does for us is it allows the HVAC business to have greater scale because of the compressor volumes. It really helps our compressor business get greater scale because of the HVAC compressor volumes.

Our cap here is much larger in the compressor space. We can punch outside our weight with the centrifugal and larger compressor technologies. They're machined, they're manufactured, they're designed, they're tested, all by that same network of excellence.

Steve: Here's the challenge I see, is basically, your stock is at a discount. You don't want to do a mid-size deal. Seems like there's some stuff that could be bigger out there that'll be pretty attractive from a synergy perspective.

Mike: We want to do a mid-size deal. We just want to do a good mid-size deal.

Steve: [laughs] You said it's a challenge to find something of value.

Mike: We want to do one.

Steve: If you want to do something bigger than the two billion, you've got probably a billion and change of leverage, capacity. It would seem to me like you'd have to figure out a creative way, either a merger, or even issue a little bit of stock, which, at your multiple, wouldn't seem to be the most attractive route.

Am I looking at that the right way, as far as the whiteboard of what you're trying to evaluate?

Mike: It depends on what you're buying, and it depends on the leverage on top of what you're buying, as well.

Oftentimes, we'll find very strong cash flows out there with targets that, again, a two and a half billion dollar value with the right sorts of cash flows and leverage, combined with our billion, or maybe a bit more firepower in the balance sheet, you can get those things done. That's not so much of an issue.

Steve: Unless you do something with a higher multiple business, like industrial which sounds like you do not want to do that because there are real synergies there.

Mike: We just have to overcome those. That's a bump there.

Sue: I think the other point, Steve, is you start out with a strong balance sheet as you indicated. We've got room on the balance sheet, but if you're doing a good transaction that creates an earnings and cash flow stream, that actually counts toward that whole leverage metric.

It isn't just a point in time with our leverage calculation. Today, you add on the great thing that you find. Combine great asset and you have a good value creation, you're just going to continue to strengthen that balance sheet. It does work over time.

Steve: You think the organization at this stage of the game is ready to go from an operating perspective. I believe that personally, but it seems like you're foot forward and on offense and confident about being able to do something.

Mike: If you think about the spin, the acquisition of Hussmann and the acquisition of Cameron, all of the '17, last year, with the ones before that, all of those have gone really well, including Cameron. There's no doubt about it. My worries are making sure that's a great strategic step, without overpaying for the opportunity.

Sometimes you catch these things at the wrong part of the cycle, but if it's strategically important to the business, that's sometimes what you need to do in the long run. You've got to take a long-term view toward some of these businesses. Cameron was that case.

Steve: Then, you'll have to come and talk to us for a year straight and explain things, which is always fun, I'm sure. Any questions?

Mike: Hussmann turned out to be a good story.

Steve: Absolutely, 100 percent.

Mike: Cameron is turning out to be a really good story. A lot of times, it's just going to be outside the window, the timing.

Steve: Any questions? I don't want to dominate the mic. Right here? Just wait for the...There's a webcast, so just hear the...

Audience Member: Mike, what is the percentage of replacement versus new demand in both commercial and the residential?

Mike: When you think about replacement in commercial, it's really a retrofit business. In North America, it's probably 85 or more percent of the market is going to be retrofitting the existing buildings.

If you go out to Asia, particularly China, it used to be the exact opposite, so 85 percent was new. Now, it's gone rising more to probably 70-30, 70 near 30 being retrofitted. Commercial is almost always, unless you're an absolutely emerging market, going to be a retrofit business.

It's generally sold on the need for the building to be renovated, but it also can be sold as a benefit of energy efficiency and a payback on the investment. We tend to do a lot of that work. You could say the same thing about the residential HVAC cycle in North America. The vast majority of that is going to be replacement demand.

Then, we go through bubbles like 2001 to 2006 or maybe 2012 through the present, where you're seeing new construction hitting new peaks. Ultimately, it always comes back to being a replacement business. The new construction never removes the North American marketplace. It's always the retrofit replacement market.

Steve: Still there?

Audience Member: Hi. Question on resi HVAC. Can you just talk about the online channel Amazon effect and how you're thinking about price discovery for that market?

Mike: We launched about six months ago, it took us about a year to do this. We worked with our entire dealer base by zip code to understand what the relevant pricing would be in the marketplace on our website to be able to give consumers the ability to come on to the website and be able to get a fairly tight range of installed cost of the system.

That was giving that transparency to the consumer and having that be acceptable to a dealer who would be responsible for installing that. Putting enough goalpost around that to be able to make everybody happy on that.

What we've found through that and through some other things that we've done around driving consumer demand through the web, we've been able to increase web leads by 30 percent and we've been able to increase closures on those by 30 percent. That's just really a nine-point improvement of driving through the web business that way.

We think that that transparency can be good, particularly when you have a very strong brand. Because it's not something that a homeowner, or an unsophisticated even installed or dealer can do, there is a premium paid in the marketplace for having the very, very best dealers to be your dealers.

That experience is, what if the end of the day, if the brand remains strong, our consumers get that recommendation to their friends for the next deal? You have to have an incredibly strong dealer base. Fewer and better is the key there.

Then, transparency has turned out to be a really good thing around how we drive through our plan recognition, through our website, through our closure rate to a good dealer. Then, because we know that we're giving leads to dealers that are closing with their business, we're always able to make sure that any lead we ever give to a dealer gets closed if the consumer uses our stuff.

That's a reassuring piece of that [inaudible] cycle.

Steve: One more for me on this, the portfolio and the acquisition pipeline. It sounds like you're still focused in core businesses that you're not going to go do something that is, "Hey, we're adding another leg to the stool." Maybe just talk about if there is anything that's outside the obvious core, what types of products those would be? I think you talked about some fluid.

Mike: I would say 95 percent of what we're looking at has been in the HVAC space channel and technology. In the compressor space, same channel and technology, and in the fluid management area, which is a great business for us. We'd like to scale that to a greater extent.

Very high multiple business makes it challenging from an M&A perspective. Organically, we're growing it. We'd like to [inaudible] pieces of that if it makes sense.

Steve: What's in there exactly? What is your fluid management business?

Mike: The brand is called ARO. It's 100-year-old brand. It's the market leader in air operated diaphragm pumps. All these technologies get applied into a system, gets specified deeply into the system. In that system, it's very seldom you get re-specified out or replaced out. You tend to find technologies niching in certain systems.

Steve: Got it. Any other questions? Right here.

Mike: The five percent, as I said, it's not in telematics, some of the digital stuff that we've been doing that really overlay of the portfolio. It's been another area that we're continually finding good opportunity to overlay that whole digital telematics and other digital experiences on top of that.

We recently just purchased a company that can do very quick, very accurate energy modeling. Other than taking people through the complex modeling that we do, we're able to get quite close by doing literally a Google flyby of a building.

Audience Member: Mike, you give I think two to four percent organic growth for 2018. You had good other growth in the last few quarters. I think mostly seven, eight percent. I actually was expecting a higher organic growth for 2018. Can you give us some reason or base for...?

Mike: There's a nuance to your question which is nothing has changed from the original guidance around the fourth quarter bookings, meaning that I still think those are going to be building the 2019 base. What's different, though, is that we've seen strong markets really continuing, including the book-in-turn stuff.

Again, when I talk about getting to our EPS commitment again this year and I talk about, is it 30 or 50 bases points of price cost? Is this market growing, that market growing? When you think about all the puts and takes that happen, you're definitely seeing strength in our end markets. You're definitely seeing price about what we the price would be. The realization of what we thought we needed is there.

You're seeing higher inflation, we think. The net of that, when it comes down to we're going to get to the targets that we laid out from an EPS perspective. You're right, we're going to probably see a little bit better growth, particularly in the first half of the year. I don't think it's because of the fourth quarter bookings. Those were long lead products that probably go into 2019.

Steve: Have those bookings held up? Is there any lumpiness in the bookings? How are the total booking trending?

Mike: There's an overall hum to the business which is a positive hum around the activity. Anytime you get to these larger either compressor deals or larger HVAC deals, whether or not you book them or don't, they can be choppy.

They could cause comp issues for you year to year. The overall hum of the business is a good hum to the business. Whether or not the mega projects fly and we were awarded, that's a little bit different, that question.

Steve: One more follow-up on that. You had said that on the large compressor side, that some of these tariffs are actually influencing, or the top tariffs are influencing people getting to the finish line on some of these projects.

It's interesting comment there that we're so bullish on the economy. Is there a case we made to maybe we see a bit of a pause as people reevaluate the cost base because of these tariffs?

Mike: A little broader. Somewhat tax reform I think is what's helped drive some of what we're seeing now around these compressors, but also even around the Thermo King business around trucking fleets that really are taking advantage of that depreciation. You're seeing demand here that we wouldn't have thought pre-tax reform.

The flip side of that is, through a 232 on top of that and some the long lead projects, customers are actually stepping back and saying, "What will my steel cost, my aluminum cost be in these longer projects? Let's slow down, evaluate if it will still make sense."

My worries there would be you got a good thing happening with tax reform, not such a good thing happening with 232. Right now, the enemy of all of this is uncertainty. As we try to determine where are steel and aluminum going to ultimately shake out and we're pricing for it.

You think about a two billion dollar infrastructure project using a lot of steel and a lot of aluminum, that's a big question asked. Is my ROI going to be what I thought it was before this all started? That uncertainty is not a good thing.

Steve: You can adjust the vest and breathe again.

Mike: [laughs]

Steve: Thanks for coming.

Mike: Thank you. Take care.
