IngersollRand

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Steve Winoker: Good afternoon, everybody. I am Steve Winoker, the electrical equipment and multi-industry analyst for UBS.

For our lunch keynote speaker, I am delighted to welcome Mike Lamach here, chairman and CEO of Ingersoll Rand. For those of you who don't know, Mike joined IR in 2004. He ran security; he ran train commercial systems post-acquisition in '08. Then he became president and CEO in the '09 to '10 timeframe, and obviously, there's been a tremendous transformation since then. Prior to Ingersoll, Mike spent about 17 years, I think, or so with JCI, Johnson Controls, in various roles, as well. We also have Zac Nagle on stage, who runs Investor Relations for Ingersoll Rand. I'm pleased to host both of you.

Just as a reminder, Ingersoll, again, for some of you who are new to the story, is roughly a $14 billion revenue, 12.5 percent EBIT ROS margin, $22, call it, billion market cap company with, you know, obviously, very old heritage, both on the climate side, diversified industrial side.

But, with that, I'm going to hand it off to you, Mike, for a few comments, and then we're going to go right into chat and Q&A. As in these smaller rooms, we'll have a microphone available for all of you. I like the old-school version, which is just you raise your hand and you get it. And if not, if you want to stay anonymous—and I've gotten a couple of those—just type it into the UBS app. It'll come right up to me, and Mike won't be able to squirrely know who it's coming from, so for the good questions, right?

Anyway, Mike.

Mike Lamach: Thanks, Steve. Thanks for making time for us, too. Appreciate that.

One of the things, a starting point for us, a little different than in the past, is I talk so much about sustainability. If you've been around the company, what on earth am I talking about sustainability so much? Why does it matter to Ingersoll Rand? But if you don't know us and you hear me talk about sustainability, you'd probably ask the same question, anyway.

We're really at the center, the crosshairs of what's happening with the environment, and I'll give you just a couple of examples. When you think about a North American market, and you think about greenhouse gas emissions, 40 percent of those greenhouse gas emissions come from buildings—not from cars or coal-fired plants, but from buildings. And 40 percent of that emission comes from HVAC systems. So you guys are good analysts; that's 16 percent of greenhouse gas emissions in North America come from HVAC and buildings.

If you go to newer economies, 80 percent of the greenhouse gas emissions could come from buildings, and still, 40 percent of that might come from HVAC systems in buildings, so a third of greenhouse gas emissions come from HVAC in buildings. And if I walk that through to transport refrigeration, where you've got a diesel engine which might be electrifying a refrigeration unit, which again, has emissions, you can see the relevance there again to the transportation segment.

If I got to the industrial segment, the biggest uses of energy in general industry are going to be air compressors, process heating, and process cooling. And again, those are the things that we are really good at and passionate about, sort of what the core of the company is. As you can think about the company, 90-plus percent of the company is geared to reduce energy demand in buildings, transportation, and industrial processes, and it's geared toward reducing greenhouse gas emissions in the world. So, we've had great growth over the past few years, really, as we put into the marketplace products, you know, the portfolio and services, that limit not only energy, but limit greenhouse gas emissions, and I think that this is going to be a great business for a long time.

Ten years ago, the good business I characterize today as being a great business. You know, great business probably should grow at a multiple of GDP, and I think we do that as well. You'd have to believe the world's not getting warmer; you'd have to believe that greenhouse gas emissions are good to believe that the business won't grow faster than the economy.

The other thing, for the last 10 years, we've been putting an operating system in place across the company, not just how we operate the plants and the supply chain, but how we do new product development, how we invest in the channel, how we think about growth across the company. It's really something that we're proud of, because the margin expansion that we've had has come with significant and ongoing investment in the portfolio of the company. And the operating system is also something that's generated really good incremental margins. Over the past decade, it's averaged something in the 40, 45 percent range. We like to think about incremental margins as being something that, plus or minus 5 points, will probably look like gross margins going forward for us. We think that that is certainly what we're doing with our operating system.

And then, at the end of that, we turn that into cash. We've been a top quartile cash flow ROIC company. We convert 100 percent or more of cash net income, and we have been pragmatic about distributing that. How that comes back to shareholders, and whether that's our commitment to growing the dividend at or better than the growth of earnings, or it's about buying back any dilution that we cause with share issuance, making sure that we're buying back at least $250 million a year to control that, and that, again, being chromatic between if we buy back shares, (inaudible) value, and when we look at M&A.

And so, we're going to consistently continue to do that, and I think that's been something that's been, along with the strategy of the company, very consistent around the allocation of capital within the company.

So, Steve, that's kind of the backdrop.

Steve Winoker: It's a great layout of IR. I actually want to stick on that for a minute before I get to the near-term trends, which we will have to address to get back to the long-term stuff, right? But before we do that, Mike, you and I have known each other for a long time, and the company has come really a long way since you took over in that, you know, call it '09, '10 timeframe. As you often talk about, IR's operating system is fundamental to the success, allow you to kind of be in this perpetual fourth inning. And maybe, can you review how you've changed the company culturally since joining, because, that's so important to that being true, and what areas you think still need to be most focused on and changed going forward?

Mike Lamach: Yeah. What you first realize is that senior leaders at any company, it takes a long time to build a culture in a company, and it takes a heartbeat to lose the culture in a company if you do the wrong things. But for us, being a performance-based culture is critically important, but doing one that's sustainable, which means to us that you're doing that working with people, and that what you do as a leader matters as much as how you get results. And so, when we evaluate people's potential and their promotability inside the company, it's what you've done—if you delivered results. Not driven for results; have you delivered results, and have you done it the right way? We measure the competencies that we think are important to leadership.

We know that employee engagement is critical for a leader. We don't promote people that haven't done the first two things and don't have high employee engagement. Why does that matter? It matters because, if you're trying to make change, you want to do that where people trust leadership, trust the strategy, believe that if they do well, there's a future for them, that there's a development plan for them. And so, it's been very important for us to kind of get that wheel in motion.

And then, obviously, you can't look past results. If you want to create a winning culture, you need to win. And so, making sure that we're winning, and make sure that people not only celebrate the wins, but are always looking at the perpetual fourth inning and understanding the potential (inaudible) the company is enormously important to how we think about the operating system of the company.

So, you know Steve, but early years, I mean, it was a lot of heavy lifting. You know, we certainly found people that were ready, willing, and able, immediately to get on board. Remember, at the beginning, we had six value streams, we used to call them, right?

Steve Winoker: I remember them up on your room outside your office.

Mike Lamach: Right. And we went from six, to twelve, to the company. They were product growth teams. We had six to twelve to essentially how we run the company. And through that, there's people that get on board right away, there's people that want to get on board, but they need help, and there's people that don't get on board. And, you know, what we've long experienced now is that we've got the people on board that want to be on the train, so to speak, and are comfortable managing and leading, with engagement, in an operating system.

You can't know something's abnormal if you don't know something is normal, what normal looks like, having standards for how we do things. And then, having a way of having the next new best thing become the next standard is really critical. So, that has, over a long period of time now, helped us build culture that I think is differentiating today.

Steve Winoker: And if you think about looking forward for a minute, where are you? What is the next big evolution for the company?

Mike Lamach: Part of the key has been a consistent strategy for the company, for how we think about people, how we think about customers and shareholders. And so, a part of it is consistency and that consistency of strategy, and just strong execution against all of those important metrics that matter to those different constituents is really critical. So, for us, it's constantly reassessing long-range plans and goals, making sure that we're deploying within the year in a rigorous way, golden objectives that absolutely line up and down the company to support that, and then a system that measures performance of the drivers, the drivers that really create the results at the end of the day. And then, making sure we're problem-solving. When things go off track, we teach people how to solve those problems, whether it's a temporary solve of the problem, more importantly, a root cause to solving the problem. That's become a fundamental part of the culture of the company.

You can't go to any plant we have today, and I would bet any analyst a good steak dinner that you can't go to two plants within our company today, and not see the same operating system in the company, exactly, working, and people that are actually communicating to you in a way that's consistent across the company as to what's important, and that took a while to make happen.

Steve Winoker: So, I don't think I'm going to have the keys to every plant to test that, but I'll believe you, for now.

Mike Lamach: Oh, I'll look at two of them, and I'll (inaudible).

Steve Winoker: So, before anybody is going to be patient enough for me to ask some of the long-term questions, let's just hit the near term, okay? So, maybe a quick 'round-the-world tour on what you're seeing on the climate, on the transport—I'm sorry, on the HVAC side, the transport side, and on industrial in terms of near-term trends.

Mike Lamach: Steve, the quick answer to that story is that not only every segment, but every business unit and every sub-business inside the business units is growing. I've not had that happen, really, in the nine years that I've been in the role, and you've had that really happening in every region of the world. So, that's really good news. I mean, you know, having that sort of momentum across the company is very positive.

Some of this is going to be, of course, market driven, but then we've got some extraordinary growth happening in areas that we focused on that growth. Whether that's geographic or a particular product segment, with a product growth team, we're getting the results we expect in those areas. It's no secret that the parts of the world that are most interested in energy reduction, demand reduction, and greenhouse gas emissions are the places in the world growing the fastest for us, and so that equation across 90 percent of the company is absolutely paying dividends in terms of share and in margin expansion for us. I don't think that will change. So, in a lot of ways, we're getting that good tailwind in the economy, but it's also timed with a lot of product innovation and a lot of channel innovation that's helped us.

Example: In China, the conversion that we've made through direct salesforce has been enormously successful for us, at a time when the Chinese are absolutely focused on clean air and clean water, where it's now become a badge of honor to cut a ribbon, if you're a mayor in a city that is showing a green factory, a green university, a green building. It's something that you can now really sell the economic value of efficiencies. You can sell the environmental benefit of no to low greenhouse gas emissions coming from the HVAC systems we put in place. That's very different than what was there five years ago, where frankly, five years ago, if a state-owned enterprise wasn't taking the low quote, they were probably going to have to defend themselves from why it wasn't a corrupt decision. Now, it's the opposite.

And so, you go to a place like China, where the built environment today is 10 times larger than the U.S. built environment, where that building has happened in the last 20, 25 years, and where it was built in a less efficient, less energy-conscious way. The enormous retrofit opportunity is there today, and we've timed that quite nicely with the investments we've made, and the product, and the channel, and the direct ability to sell that.

These things have gotten so complex in terms of the systems and the controls being integrated, in terms of the value that we try to sell of total cost of ownership, that we have to sell it ourselves to be able to tell that story. We have to be able to service it ourselves, because really, a mom and pop just can't do that anymore. It would be like opening a hood on a car 30 years ago; if you were mechanically inclined, you might know what's going on. Today, good luck opening the hood on a car and figuring out what's happening, unless you've got a mechanical, digital, software diagnostic that's able to take care of at least pointing you in the right direction.

Steve Winoker: While you're on that topic, then—I wasn't going to get to this until later, but the Chinese growth and investments that you've made. Can you maybe take the audience through a little bit of the salesforce investment that you've made, what traction you're already seeing given that, and where you are on that kind of runway?

Mike Lamach: Yeah, I'll start and say I always like to take people back to something we said a couple of years ago, and then kind of talk about the commitment we made, and then delivering on a commitment. So, what we said in '16 was that we thought that China and Western Europe were places that we could double, over a five-year period, by 2020, with very little investment. For us, in China, it was moving the investment from a partial direct and a partial distribution salesforce to a largely direct salesforce, and we completed that work last year, in 2017. In Europe, very little, if any, incremental investment to be able to do that. What we needed was the best efficiencies in the product and the most environmentally sound refrigerant story in the market. Once we've done those things, obviously, the compound growth rates have been tremendous over that period of time.

So, to us, it's a matter of just really executing on what we said about the doubling of the business. And the benefit here is that we're putting very, very little investment into the core structural part of the company. No plant infrastructure, because we had plants with capacity that were able to improve with the operating system, a few commercial tweaks, like changing the salesforce in China, and the, building a service business over time. We're not starting to build a service business; we've always built a business, the direct service model, for what we do.

Steve Winoker: What's the time for ramp-up for the salesforce (inaudible) what that is? People sort of think about this (inaudible) opportunity, your additional salesforce add.

Mike Lamach: Well, whenever you're transitioning something like this, you believe (ph) that the distribution is going to go very quickly, and it's going to take a long time to ramp up on getting the direct competencies up. Distribution didn't go that quickly, and we ramped up extremely quickly on the direct sales opportunity. But typically, you're working with degreed engineers, if not professional engineers, that are selling for us. We put people through a six-month classroom experience. Twice a year, we go through formal classes that are full-time. And then, people generally apprentice for a while with somebody who is strong in the trade. So, what used to be maybe 18 months, we've compressed to 6 to 9. We're already over that hurdle, in my mind, in China. We're past that. And we saw the service business, actually, in quarter one respond exactly as we thought it would, meaning it's just trailing the equipment business by six to nine months.

Very interesting that five years ago, when we sold equipment in China, we linked it to about 20 percent service, take rate. Today, it's two-thirds. And if you think about Western Europe and North America, it's closer to 80 percent. So it very quickly emerged because of the complexity and importance to save energy, and the importance to get the environmental performance.

Steve Winoker: Just to be clear with everybody, the service attachment rates on original equipment sold has now gone up to almost two-thirds, or two-thirds, and mature markets is 80 percent. And are we talking only sort of large commercial-applied type units, or how—

Mike Lamach: Well, you can think about it; in Asia, that's generally what we do. We don't do residential in Asia. So, anything we do, typically, in Asia—

Steve Winoker: Or light commercial.

Mike Lamach: We do a little bit of light commercial, but the service that we're talking about, generally on more sophisticated systems that are normally applied, but not exclusively applied systems. Applied is just a term that means engineered to suit, as opposed to sort of a catalog product. And the vast majority of things we do across the world really are moving toward this ability to actually engineer the application for the customer.

Steve Winoker: Before I follow up on that, just a quick question: how many sales engineers do you roughly have, an order of magnitude—

Mike Lamach: Thousands.

Steve Winoker: And in China alone? Hundreds?

Mike Lamach: More than 500.

Steve Winoker: And service techs?

Mike Lamach: Over 5,000 across the globe, 1,000 in China.

Steve Winoker: Okay, so building on your point around engineered to spec, this has to take me to another short-term question, which pricing and pricing power, both across the commercial, and then the residential—light commercial businesses globally. A lot of your peer companies are appropriately focused on pricing and productivity, offsetting wage, material, and freight inflation. Could you just give us an update on where you guys stand on that front?

Mike Lamach: I'll start with a long-term answer to a short-term question, which is these are usually painful but good times in the industry. If you think back to '14, '15, '16, when copper and aluminum were spiking and people we're worried about this, you saw the industry putting a lot of pricing into '14 and '15. You saw at '16 a pullback in commodities, and in our case, we saw a 160 basis point spread between pricing and material inflation. If you stack up '14, '15, and '16, it was better than a point of margin.

If you look at '16, '17, and '18, do the same price stack, do the same material cost stack, it's more than a point of price material inflation. And you go forward; you've got '17, '18, '19, or '18, '19, '20, what you're having now is a tremendous amount of price being put into everyone's standard costs, and ultimately, at some point, you're going to have either normalization, once sort of this whole tariff discussion is really settled, certainly more of the speculation kind of coming off of some of the non-ferrous metals. When that happens, the same spread should occur again.

So, 33 years that I've been doing this, I've been through this at least five times. Five times, the industry has performed this way, and I see the build now, where a lot of price going in to cover those costs. At some point in time, those prices stick, and inflation either flattens or abates.

Steve Winoker: Do you think there's any demand response—I don't mean in a thermostat standpoint, but a elasticity of demand, as a result of these price increases? Or do you think it's going to be relatively inelastic? In other words, do you think volume comes off at all, due to the price increases—

Mike Lamach: I don't. I mean, you know, it's one of these things that just historically, as you go through these cycles, including this one, price gets built into standard cost. This is not an industry where people index things, I think because the bias over time is that price sticks. You don't see people surcharging things, because eventually, surcharges go away. You tend to see it built into standard costs, and then you tend to see the competitive landscape act with the same input costs in the same way. So, you know, what we're seeing here today is what's happened in the last five cycles that I can remember.

Steve Winoker: And then, again, to be just crystal clear for everybody, from a short-term perspective, the guidance and everything's intact, despite some of these inflationary headwinds.

Mike Lamach: What we said on the last guidance call we had was that we thought quarter three, quarter four would be flat. In other words, price and material inflation would be flat. We're not updating anything here on that. But, as you think about, then, the first half of the year being negative, the second half of the year being flat, we'll be down sort of 30, 40 basis points. That would work the math on that.

As you look into 2019, this is where we like to get 20, 30 basis points of positive spread as part of the planning process. That's what we would normally gear up to do. And then, depending on what happens with any kind of kind of reduction in material costs, you could end up with a wider spread. We like the setup here, particularly as it looks toward our 2020 targets. It's hard to imagine a point in time where you don't get some flattening of inflation, if not a reduction in some areas, while price is still being systematically built.

Steve Winoker: Okay, I wasn't going to head there yet, but since you raised it, again, and I want the audience to hopefully start thinking about questions if you already don't have them, and love to see some hands go up in a minute. But, since you mentioned it, longer term, those 2020 operating margin targets are around 14.5, 15 percent, let's say, right, that you set. What's your conviction, and what has to happen for you to achieve those targets? How important are they, as well?

Mike Lamach: Yeah, it goes back to the base case I made at the opening. You know, really, 4, 4.5 percent organic growth is what will be put into the equation, leveraging at 50 to 75 bps (ph) of margin expansion a year, turning that into cash, and allocating it in a sensible way is the way we get to the midpoint, really of that whole guidance range. Clearly, we're seeing a better growth environment since we issued that guidance. We're seeing a tougher material inflation backdrop to that. At the end of the day, we'll work the P&L, we'll work the balance sheet to get to what we committed.

Steve Winoker: And are there things that you're doing that you're seeing a lot more benefit, other than volume, in terms of productivity or other new initiatives, or digitization, and are things that will help you with streams that come in at higher gross margins, higher operating margins, in terms of the mix?

Mike Lamach: So, the answer is yes to all that, because that's really what I talk about with an operating system. It's a system of things. You can't pull a lever, and that's your lever for the year. We always have to have a new technology, a new product development pipeline. We've got to be squeezing efficiencies out of systems. We have to be looking at being able to compete to grow market share and margins, and that's that part.

The part that would be operating the plants and supply chain, it's making sure that the pipeline of productivity—we like to have 125 percent of what we're actually thinking we need in terms of projects that are calendarized and active, meaning they're going to fall within a quarter or a month, in a way that we think we can maintain margins, margin expansion (inaudible). So, constantly looking at direct material, indirect material, direct labor, indirect labor, value engineering, value analysis, fixed costs; those are all systems that have to have a pipeline. And when we fall below that pipeline level of 125, there is a flag, and there is an emphasis on regenerating and doing rapid improvement events, and doing work to be able to get that pipeline rebuilt.

Steve Winoker: And I want to add one thing, or suggest one other question, which is the percentage of your business from service, right, so that also helps your margin flows. I think it was 30 percent or so in '09, mid 40s today. I think you're aiming for, what, 50 or so by 2020?

Mike Lamach: Yeah, in Western Europe and North America, it's really 50. As you get to, you know, Asia, we talked about it, it's growing up dramatically. I would think by 2020, we're certainly closer to the 50/50 mark. We've grown service, compound over 10 years, at high single digit growth rate, roughly 8 (ph). That's good growth, and that's so important around getting that service mix, which is, at a contribution level, worth a lot to us—3 to 5 points contribution margin in the service mix.

But think about the downside to that. If we're able to really think about 50 percent of our business being service related, when any kind of a market pullback, market weakness in any one of our equipment businesses, that is an absolute change, relative to the starting point in '08, '09.

Steve Winoker: And therefore, my next question around resilience of the business and the next recession, which will happen someday, versus the last one. I think people sometimes, in my conversations, get still hung up on the old Ingersoll Rand and the old volatility in the business. I think the mix is dramatically different, and you're sort of alluding to it. But, could you be more direct about how you've thought about it?

Mike Lamach: Yeah, I'll use an example, probably best. I'll take one that we get a lot of questions about. You know, folks generally will take a headline and associate that headline to an outsized impact to our company. One we got is our exposure to what people broadly think about as being the commercial construction cycle in North America. It's interesting for us, because when we think about that, we're thinking of roughly—and I'm going to round some numbers here, but roughly a $4 billion North American HVAC business, of which $2 billion is service and $2 billion is equipment. Well, the $2 billion that's equipment, the first way to think about that is 85 percent of that is replacement, and so, so long as there's an economic story to tell—a critical facility, a hospital, a school, a research center, an office building—you're going to need to be comfortable. And if you're not replacing it, you're extending the life of it; you're fixing it; you're servicing it. Our service businesses always go up in a downturn, so that's important to mitigate that.

We have people that understand the market's a bit more detailed. They think about institutional markets and kind of commercial markets. If I take that same $2 billion in equipment and I split it another way, $1 billion of it's institutional. That's absolutely on the upswing. The other $1 billion of it is a combination of commercial and industrial. Industrial is on an upswing. I'm talking about process cooling, process heating, that sort of thing. Now you're left with this commercial piece, which is everything from data centers, which aren't going to down, all the way through to retail food, fast food, and everything in the middle (inaudible) office buildings, hotels, et cetera.

So I think sort of the broad exposure to lots and lots of vertical markets here, the broad exposure to replacement in North America, really sets up well in a pullback, where people have to extend asset lives or continue to run mission critical or critical facilities.

Steve Winoker: Does that extend—I mean, again, given the recession, we have very different kinds of recessions, so it's hard to sort of say what the overall market—but relative to the market, you would expect less of a trough and decremental margins to be held better than prior (inaudible) people just working through their thinking on the numbers and whatnot.

Mike Lamach: Yeah, 30 to 45 percent service mix difference is part of the antidote to that. Growing ourselves, doubling in Asia, doubling in Europe is a bit of an antidote to that, if it would be a North American cycle. I mean, a global, deep recession, everybody's going to get sucked into that. But again, if you think about the need to kind of keep extending asset lives, that's why we invested so heavily in that service channel and that service business, because we want to be the people extending lives of equipment and systems to be able to do that. So, I think it's a very resilient company in a downturn.

People will take TK (ph) and say well, you're so North American focused on trailer (ph). Well, the trailer peak was 2015. There's no peak happening in 2018. It's probably 5, 6, 7 percent down from the '15 peak. People thought, well gosh, Ingersoll's so exposed to this, and we're going to de-leverage, and all that. We grew Thermo King, and we made—we expanded (inaudible) Thermo King. We did that because an auxiliary power unit, a 3 to 7 (ph) class truck business, plus rail—we didn't have a (ph) rail business before; an aftermarket business, the telematics business, an air freight business. These are all businesses we didn't have, you know, sort of last time something happened like that.

So, I think we built, within the businesses, more resiliency, and across the portfolio, resiliency, whether it's regional or just by virtue of being industrial and climate focused.

Steve Winoker: And that would apply, just to stick on this for one more question, even if some of my colleagues are correct that we're kind of peaking out next year in the truck cycle. Or, you know, I know you see orders that are hard to keep up with on that right now. But if that were to play out, that diversification that you're talking about sort of is made up for elsewhere.

Mike Lamach: Yeah, in context, you're talking about a $15.5 billion company, of which $2 billion is Thermo King, of which probably something like $400 million is North American trailer. It's not the most profitable part of Thermo King or the company. And if you think about sort of what's your expectation about what happens, does it go down 20 percent? Well, that's $80 million. You know, apply general leverage on that $32 million in income, you know, it's (inaudible) $0.09 a share.

What about institutional construction? What about growth in Asia? What about growth in Europe? What about our industrial business, our service business? So, again, not sort of taking the headline, but in our company, what you really need to be thinking about buying is a tailwind around sustainability and energy, with really strong brands, high product and channel investment, sort of really position the company well, a big, big service business doing replacement, asset life extensions. We turn it into cash, and we have been thoughtful about how we distribute it, and that's a pretty good model for whatever the future holds.

Steve Winoker: I want to now purposely pause and really try to see if I can generate a hand up in the audience anywhere. Anybody? We have one, right in the middle table. Is that right?

Unidentified Participant: The question is, in terms of commercial HVAC peers, where are they in terms of service mix, do you think? They don't disclose in the same way necessarily, but if you know the number, that would be great; if you know anecdotally in the field what you see, that would be great. And where is the share coming from? I presume it's mom and pop, but I'd like to understand that more.

Mike Lamach: Well, actually, let's take the mom and pop thing. It gets back to the opening the hood on the new car and trying to figure it out. You're really building now this equipment where controls and equipment are integral. In fact, you could think about building equipment around the controls. You're instrumenting these things out with the ability to read, and software, and algorithms that drive efficiency. So, it really favors the OEMs to service the equipment, and the equipment requires service. So, in essence, you know, you're going to find that it's going to be 80 percent, eventually 80 percent-plus, mix of take, service to equipment. So that's the first piece of this.

A lot of the competitive models are different. Rather than telling you kind of like what I think about everybody's competitive model, (inaudible) our competitive model. We think that equipment and controls are ubiquitous. You've got to be great at both of those if you're going to drive efficiencies out of systems and buildings. You've got to have a direct salesforce, because it is a sophisticated sale, modeling the building, working with consulting engineers, with owners, contractors around options and alternatives. The ability to then directly service that, because you just can't count on somebody else servicing the stuff into the future. There's a profit stream there and a need to do that. and then, all the investments that we're making around the digital aspect, whether it's telematics, or whether it's using data coming back from the systems to improve service delivery performance, or guaranteeing service outcomes, and then we decide how to deliver that service, digitally versus maybe manually through labor going out to the field.

Our model is that. That's why we've invested heavy in equipment and controls; that's why we invested heavy in the service channel; it's why we invested heavily in the digitization of what we're doing across all of that, and that's our model. And everyone's got a little different view on that, but I think at the end of the day, we want to grow market share and margins. That's what we're doing, and until that formula doesn't work, that's the formula that we're going to keep running with.

Steve Winoker: Maybe just address quickly within that context your VRF strategy and partnerships, and what that does for you. And also—well, I'll just leave it there for now.

Mike Lamach: Yeah, we make VRF around the world, and we partner with VRF around the world. It's really (inaudible) decision. To us, we found that the channel is vitally important about how you enter than market. We don't think about it as a white good business, and that's why residential (inaudible) is not so exciting to us. It's a bit of a white goods business, as opposed to VRF, which can be more of an applied sale, if you will.

So, when we think about that, we in earnest really began to, in North America, grow the

VRF business about four years ago. We grew it at about a 45 percent compound growth rate. The industry is probably growing at about 15 percent. Clearly, the channel makes a difference in how you sell VRF, in this market, anyway. Part of this was, four or five years ago, we may not have been getting the attention around VRF. We saw it as an opportunity. A lot of folks thought about it as a threat for us. It turned out to be a heck of an opportunity.

So, the partnership with Mitsubishi really gives us a long-term partner around the product. We like the Mitsubishi product because we always have thought about the efficiencies and reliability of product being better than the rest of what's out there. We, together, put a very large support organization in place. We've got nearly 500 people in only the support organization, not the sales organization, around that, and believe that we're going to continue to drive really high share there. (Inaudible) clearly, the number-one position in VRF in North America, and we like our positions around the world with other strategies, whether it's making it ourselves or partnering with other people, as well.

At the end of the day, what's going to happen is you're going to see ducted businesses growing faster in Asia, which is what's been happening for us. You'll see ductless business growing faster in more Western economies. And over time, it's all going to normalize into you need everything, and you have to fly (ph) it in the right way.

Steve Winoker: So, is there risk from an investor perspective that that partnership, should it evolve where year partner decides they want to start going direct someday, you have protection capability, that that is not something we should worry about?

Mike Lamach: Yeah, the way this works is we are the channel. We are the channel. It's a long-term contract. You could imagine, you've got two large, sophisticated companies that have negotiated this agreement to make sure that both are protected in that. It's envisioned as being long term, and we are the channel. We're agreeing that, on the high end of the VRF market, that's the technology, but they're agreeing that on the market, whatever the market is, we are the channel. So that's the way it works.

Steve Winoker: I want to make sure we get a couple more things in. One, before capital deployment, which is on just the industrial side of the business, you've commented in the past about kind of impact of the macro environment, tariffs, et cetera, on buying decisions, buying behavior of your customer base. What are you seeing out there now?

Mike Lamach: Well, the fourth quarter was interesting, because actually, in December of the fourth quarter is when all the bookings of industrial products and compressors happened. I thought, frankly, it's really associated to the benefit of tax reform, people thinking about the depreciation of those assets and the benefits of that. Truck customers are doing the same thing. Fast-forward now, and you're talking about tariffs, and you might have a customer that's building a $100 million project. We're a $2 million supplier to the project. Customer's got two questions: One is, is my $100 million project now $110 million because of what's happening with steel and labor? The second question is, even if it's $110 and it still makes economic sense, do I want this plant located where it is, because I don't know what the rules of the game are going forward.

I think what you need is certainty around the rules, and once certainty takes effect, I think companies will make decisions about getting off the fence and where to locate capacity. If they need capacity, they're going to put it in the world where they need it. The fact is, they're going to need capacity. It's just a matter of where they're going to locate it. So my sense is that once this—so we went from a 15 percent growth rate in the fourth quarter, really December, to a 5 percent growth rate in the first quarter.

Steve Winoker: In bookings.

Mike Lamach: In bookings, and that's a little bit of a cold water poured on top of tax reform around this tariff discussion. You know, and companies aren't dealing with this in a political way. They're dealing it with the economics of the rules, and if you tell us what the rules are, we'll determine the best way to position the capacity and to go about the investment.

Steve Winoker: So you're seeing these kind of live causes across your base in your own conversations with the folks who are running some of these other companies or making these decisions?

Mike Lamach: Absolutely. General industry, I mean, so there's going to be, you know, parts of industry where you might need to be on (ph) air separation, depending on what's happening with oil and gas and how people think about that. But you're seeing that for general industry, that's a big question where you're going to see more of this impact of tariffs and more of the location of the physical production facility in general industry.

Steve Winoker: On the energy side, since you mentioned oil and gas, Cameron (ph) and all these other—what are you seeing?

Mike Lamach: Our oil and gas business is tiny. Even Cameron's got a very little focus here. It's certainly much more of a derivative effect for us. The one business that we have, which is material handling, is a small a business that's grown 40 percent over the last year, so you definitely see some growth, green chutes that are happening in oil and gas so far.

Steve Winoker: All right, and now, again, while we're on it, on capital deployment, and we're getting smaller and smaller in parts of the portfolio. So, how do you think about—I think it's, you know, if we look over the past four years, something like 20 percent or so to acquisitions, 14 percent CapEx, the rest to buybacks and dividends. So, as you think about the strategy going forward, you think about high-priority business for M&A, you think about parts of the portfolio like—I'll say it—Club Car and others, I mean, where's your head these days?

Mike Lamach: It starts with investing fully in everything organic that we can think of that's got ROCs (ph) that are value additive to the company. Once we've done that, there are some principles around the dividend growing at or above net income. There's a principle around dilution in the share count. And then, there's a pragmatism around how you think about M&A and share buyback. And here, rather than saying we're going to deploy so much to M&A, I think companies get in trouble when they do that, because then things look good that probably shouldn't look good. We say if you hold a mirror up between intrinsic value and the share price, and M&A on the other hand, what's the best decision you can make today, with the premise that cash is not going to build on the balance sheet. Therefore, you're going to deploy it, deploy it in excess cash in one of the two areas. Last year, we bought 17 companies, happened to be smaller tuck-ins or technology companies.

That's the way that 2017 worked out for us, as an example.

Steve Winoker: Well, okay, but the intrinsic value mirror right now is looking pretty healthy for repos on my end, so what do you—you know, is there a chance that that gets larger?

Mike Lamach: Well, I think for five years, we've put $6.5 billion, or about a quarter of the market cap of the company back into share buybacks, so I don't think it's anything different about what's happening now versus what's happened over five years. You know, that intrinsic value that we've seen in buying our own shares back has been valuable to us.

Steve Winoker: Great. And as you—I guess maybe lastly, both what do you—any final investor questions? I'll always give it to you guys, rather than take it. No? All right, so I'll take it then. What are the, right now, are the things that are kind of—it's not keeping you up at night? Where are your biggest concern or two, and then we'll end with where your biggest—where you're most excited.

Mike Lamach: Yeah, it's not totally, you know, sort of if we put a dollar of incrementals on top of the funnel, I'm pretty sure what's going to come out the bottom is going to be something very healthy. That's not what keeps us awake at night. What keeps us awake at night is some of the uncertainty, just what's happening around the world. It's the macro things that you can't control. I think every company today is more worried about those sorts of things. Where the global economy is good, you know, we're seeing that, as I mentioned at the start, with all of our businesses and sub-businesses regionally. So, we worry more about those shock factors, you know, escalating tariffs, more isolated approaches to policy. That type of thing, I think, would certainly hurt.

Steve Winoker: And most excited, if you had to point everybody to one or two things?

Mike Lamach: Yeah, there's not just one or two things.

Steve Winoker: I know.

Mike Lamach: Yeah, it's really—I think that there's enough in the pipeline around innovation and growth that we can keep a gap between us and, hopefully, the competitors around how we're thinking about the next level of efficiencies and the next level of what we're doing in the market. And again, operationally, I feel like we've got a good team delivering every day, every month, every quarter, and that's something that I've learned to count on.

Steve Winoker: Any final comments, Mike?

Mike Lamach: Thanks, Steve.

Steve Winoker: Well, thank you very much for joining us. Thanks to everybody.

Mike Lamach: Thank you.