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JCI - Q1 2016 Johnson Controls Inc Earnings Call

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OVERVIEW:

Co. reported 1Q16 revenues from continuing operations of $8.9b and diluted EPS from continuing operations of $0.82. Expects FY16 diluted EPS to be $3.70-3.90. Expects 2Q16 diluted EPS to be $0.80-0.83.

CORPORATE PARTICIPANTS

Glen Ponczak *Johnson Controls Inc - VP, IR*

Alex Molinaroli *Johnson Controls Inc - Chairman & CEO*

Brian Stief *Johnson Controls Inc - EVP and CFO*

Bruce McDonald *Johnson Controls Inc - Vice Chairman and EVP*

CONFERENCE CALL PARTICIPANTS

Robert Barry *Susquehanna Financial Group / SIG - Analyst*

Jonny Wright *Nomura - Analyst*

Julian Mitchell *Credit Suisse - Analyst*

Mike Wood *Macquarie Research - Analyst*

Josh Pokrzywinski *Buckingham Research - Analyst*

Colin Langan *UBS - Analyst*

Patrick Nolan *Deutsche Bank - Analyst*

Noah Kaye *Oppenheimer & Co. - Analyst*

PRESENTATION

Operator

Welcome and thank you all for standing by.

(Operator Instructions)

Today's call is also being recorded. If you have any objections you may disconnect at this point. Now I will turn the meeting over to your host Mr. Glen Ponczak. Sir, you may begin.

Glen Ponczak - *Johnson Controls Inc - VP, IR*

Thanks operator and welcome everybody to the review of Johnson Controls first-quarter 2016 earnings. If you didn't already receive it, the side presentation can be accessed at the investor sections at www.JohnsonControls.com.

This morning chairman and CEO, Alex Molinaroli, will provide some perspective on the quarter, as well as some updates. And he will be followed by executive vice president and chief financial officer, Brian Stief, who will review the results of the individual businesses, as well as the Company's overall financial performance. Following those prepared remarks we will open up the call for questions, and we are scheduled to end at the top of the hour.

Before we begin just want to remind you that today's comments will include forward looking statements that are subject to risks, uncertainties and assumptions that could cause the actual results to be materially different from those expressed or implied by such forward looking statements. The factors that could cause results to differ are discussed in the cautionary statement included in today's news release and the presentation document. We also remind you to review the extended disclosures related to the proposed transaction with Tyco which can also be found in the earnings documents today.

With that I will turn it over to Alex.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

Thank you, Glen.

I first want to acknowledge that this is probably the first time in years that Bruce McDonald has not been on the agenda. But just for everyone's sake he is here, so when we get to the Q&A we'll make sure that Bruce gets an opportunity to keep his string alive. What I would like to do before we get started is just remind everyone -- it's been a while since we had an opportunity to talk, and I wanted to remind everyone that in December when we had our analyst day there 's some themes that I want to hit on.

We talked about execution and over the last couple of years I continue to be completely satisfied with our team's ability to stay focused, particularly as we transform our portfolio, our teams within the business units have been focused on reinvesting and growth, but most importantly being able to improve margins and continue to meet our commitments. As we talked in December we made a lot of progress around our operational excellence at Johnson Controls operating system. It continues to bring and yield results for us as a Company and within our business units.

I think after the auto spend, we talked a lot about that, and Bruce had an opportunity to meet with a bunch of you in January in Detroit about the automotive business, about Adient, and we will be well positioned along with the automotive business to be two great companies after the end of this fiscal year. And I am pretty excited about that. As it relates to the path of the remaining Johnson Controls, I think that, particularly as we talk about our announcement earlier in the week and the portfolio changes that we made up to this point and how we have invested within our businesses, I think we're really on a path to achieve our multi-industrial status and make sure that we are in a position to reinvest in the business and continue to increase shareholder value.

With that I will start on slide 7. I won't spend a lot of time on this, but I just want to break a few things down for you to make sure that you understand that from an organic standpoint, although we are not exactly where we want to be, I am seeing some momentum in the business. If you sort out some of the numbers you see that our FX has impacted us negatively along with the drop in lead prices within our power solutions business. Brian will talk about that when he gets into each one of the businesses.

Also you have to take Hitachi and you have to make sure that you know that we now have that consolidated within our quarter, and it's over half billion of increased revenue, but then you have to take the deconsolidation of the interior's joint venture out, and it is over $1 billion. If we look inside our businesses, what you see is automotive business really exceeded our expectation around production levels across the board. That would include China, by the way.

And then BE is up organically 1%, and that excludes Hitachi and FX, and we higher revenues, particularly in North America and the Middle East. And we'll talk later about North America, but we are seeing some real momentum in that business. That -- we saw earlier, and I think last quarter we had a little bit of a hiccup because some of the federal government work, but the secured sales continue to come, and our top line, I think, is in a position to continue to grow.

And then Power Solution if you take up the unit volume and you take out lead and FX, we had a 3% growth, and I am particularly happy with some of the sales increase we have in China. Once again we continue to see margin expansion in the business at 130 basis points across-the-board. In auto we had record performance. We have never seen this kind performance before in our first-quarter.

We continue to see improvements within that business. And so we are setting that up for success. And then Power Solutions again with margins that are almost 20%. A little bit of benefit from the low -- the pressed lead position, but still we're seeing margin improvements within the Business. And now we're seeing BE with the reinvestments into that business with a real position -- in a real position to grow.

If we go to slide 8, let's talk about a couple things here that I think are pretty important. I am pretty proud of how our team is accomplishing, and as I said earlier and with the segmented interim margins up 130 basis points and EPS 11% versus last year, even with a little softness in the top line versus where we wanted it to be, we have got a lot of headwinds in the business that are outside of our control. We continue to deliver on the bottom line despite that.

And of course, as I said earlier operational excellence across all of our functions continues to improve, and I would say that it includes everything from our procurement, our manufacturing operations, our supply chain and the productivity we're getting out of our sales force. We have a challenging macroeconomic environment, but we are gaining some momentum. If you look at our SSNA, our North American branch business, we saw orders grow in Q1, and we see the pipeline are up. If you look within North America, and you just go to North America, you can see that orders are up 13%.

Our chiller market share is up 170 basis points. Our hit rate is up; this is historical highs. And then within Q2 we see the pipeline continue to grow. So the institutional market focus that we have, I think, is starting to pay off. It's been a long time coming, but hopefully we will continue to see that happen. So, we expect to see revenue growth and the pipeline continue to increase.

Actually in Asia orders were up significantly in the quarter. In the context of things that we saw three quarters of orders being down prior to that, so we were happy to see Asia orders being up. And if you look at Hitachi, we're pretty happy with where we were. Now it exceeded our plan. We have a long way to go with Hitachi and the integration, but the integration is going well, and as it relates to what our plans were for Hitachi, we had more profitability and better operational performance than what we had planned.

So off to a good start there. Power Solutions, great quarter, some real milestones. I was reflecting on Power Solutions and some of the growth. We are going to be adding some more capacity as we speak. Within 2017 we'll have another 6.5 million of units in a new plant in Power Solutions in China.

And we hit a record of 1 million units of battery ship in China during December and a little bit less than 3 million units for the quarter. I was reflecting on that because over the past few years when I was at Power Solutions when we had our problems with the Shanghai plant, that plant was a 3 million unit plant.

So as we've move through the past few years we are now selling in one quarter our total capacity what we had when we first entered China with our Shanghai plant. And then AGM growth continues to be something that is accelerating. Our biggest challenge here is keeping up with capacity. We had a 41% growth in AGM, so the mix is working in our favor.

You go to slide 9, we'll talk about the auto separation, the Adient spin off in a few minutes. And as you all know we introduced the fact that we will merged with Tyco earlier this week. I am incredibly excited about what I've seen so far. The reaction by our customers, by our employees and by the folks that follow us, our investors, I do think it's going to be a win-win for both companies, certainly for our customers and our shareholders. And sp I look forward to working with our partners at Tyco over the next few months as we work towards close. I think that it's just going to be more exciting times to come for both companies.

Back in December I think there was a little bit of disappointment. We talked about fact that we were just a little unsure of ourselves as it relates to our share repurchase program, and we wanted to pause that while we really understood what the cost and the cash flows were going to be associated with the automotive spend. I got a lot of feedback there at the meeting that there was a little bit of a surprise.

I think it was the right thing to do, but we now understand how this is all going to come together, and so we're going to reinstate our repurchase program in the second half of this year. I think the stock price is at a place where it's a really good buy. We plan to repurchase half a million shares by the end of the fiscal year in the second half of the year. So I'm happy to report that.

Go to slide 10; you know that Bruce announced earlier this month, I found out just right before you did the name of the new Company, Adient. It's a really exciting step forward. A lot of things that are on this slide are consistent with what you saw if you were -- if you either had the presentation or you were at the presentation that Bruce gave in Detroit. There was only one real significant difference is that since that time we have actually received another piece of business, a Hyundai Kia replacement business and a VW metals program, and so that moves from the $650 million in replacement program to $750 million. And of course we already had talked about $850 million of new business that we have seen in the business since -- essentially since we made the announcement.

The team is working hard around separation. We are not seeing any hiccups in the business itself. In fact, we're seeing momentum. The team is really excited about their future. You'll get some more information. The 10 form -- the form 10, excuse me, which should be out late March or early April. When that comes out I think you'll get some of the details that you're probably looking for as we work toward getting that complete.

I don't want to jump ahead of ourselves, and so, when that comes, I think a lot of the questions that you might have and some of the things we're still working through will be answered. And then I think that as we talk about our capital structure, Bruce talked about that, and nothing's really changed as it relates to how we're thinking about capital structure for Adient.

On slide 11, I'm not going to spend a lot of time on this. This should look familiar. The Tyco and Johnson Controls merger if you look at the key points on this particular slide, I just want to talk about a couple things and make sure that it's absolutely clear. You know we've gotten a lot of feedback over the last week. We see $650 million of synergies and including operational and the tax synergies that we are going to get from the deal. That's something that we've taken the bank, and we feel very comfortable that we will be able to achieve.

What we don't have in that is any revenue synergies. One of the things that you can expect from us over the next few months as we fully understand how that is going to come together and how we are going to integrate specifically, you can expect for us to update these numbers to include revenue synergies and the timing for that.

We've positioned that as all upside to make sure that we did not set some expectations that we could not meet. I can tell you internally our teams are incredibly excited about this opportunity, and I spoke with George Oliver, and his team is, too.

Post merger, prior to any of the synergies, we are talking about a Company with $4.5 billion of EBITDA. I think the financial flexibility we will have as a combined Company certainly we will be much enhanced from what we have today and what RemainCo would have had without the merger.

You go to slide 12, I've -- we've gotten a lot of feedback over the last week, and so we tried to put a slide together that I think is going to be very helpful. There's been a lot of feedback that we've gotten to make sure that people can understand, because we are merging and then spinning, what is the value to the JCI shareholder and how -- what are the mechanics and what's included in and what's not included. I think this slide certainly goes through some of the questions that we've gotten.

In particular, I'm not going to go through the entire slide, because I think most of this stuff is something that you've -- that we've talked about and that you've been able to understand. I think that the share repurchase helps you understand how we get from the current 650 million shares outstanding to the future combined Company of 940 million shares outstanding after the repurchase program.

If you go back into the appendix, there is a slide that I think can help you get from the 650 million to the 940 million shares, and that might close some gaps for some of the folks here on the phone that were trying to understand some of the metrics around this deal. The $10.5 billion net debt is an important number. If you look at what our net debt to EBITDA is we will be in a strong position as I said earlier to be able to have some flexibility moving forward.

With that, I think that as we move forward, we look forward to your feedback to make sure that we are as transparent as we can and make sure that you can -- it helps you put together your models. I do know that it's a little bit of a challenge with a couple of the moving parts that we have here.

With that I am going to turn it over to Brian and let him go through the businesses.

Brian Stief - *Johnson Controls Inc - EVP and CFO*

Okay, thanks, Alex, and good morning, everyone.

Before we move into page 13 just a couple housekeeping things. As you saw in the press release our Q1 results from continuing operations are adjusted for the $87 million in separation cost, primarily related to the Adient spinoff that we incurred in the quarter.

And as I talk through the business unit results and the financials, I'm going to exclude the $87 million in costs from my comments consistent with what we guided to previously to exclude those type of costs, and I will also comment on just continuing operations as we go through the slides here. As you know the formation of the Automotive Interiors joint venture in July 2015 and the closing of our Hitachi joint venture in October 2015 does impact the contrary comparability of the quarter-to-quarter results, and so I will also refer to that as I go through the commentary here.

Lastly, we did file a form 8K today, and that form 8K will break out for you the FY15 results with our new reportable segments for BE. It will give you an annual FY14 results, as well. And then as we move through 2016 you will have a comparable quarter amounts for the four new business segments of BE.

And those four new business segments are systems and services North America, products North America, Asia and rest of the world, and we have outlined a mapping as to our old segments and in new segments in an appendix to the slide deck. So, with that, let's go through slide 13 on building efficiency. Their sales in the quarter were $3 billion, which were up 18% from the prior year.

If you adjust for Hitachi and FX, sales grew by 1%. Revenues in our systems and services North American business with were up 4% year-over-year. As Alex mentioned, we continue to see good momentum in the North American branch business. And the Middle East was up 31% quarter-over-quarter. And that was due primarily to several large jobs that closed here in the first quarter.

However, Asia, excluding Hitachi, was down 3%; Europe was down 4% and Latin America was down 31%, although 31% is off a pretty small number. Orders secured in the quarter excluding Hitachi and FX were up 5%. We are very pleased with the share gains we saw in the North American region where orders increased 8%.

As Alex mentioned Asian orders were strong in the quarter, up 10%, and we did see a bit of softness in the rest of the world. Backlog is consistent at $4.8 billion, and we continue to see strength in the systems and services North American business as far as the new business opportunities pipeline for the next six months which is up 7%. If you look at segment income year-over-year up 10%. Ex Hitachi and FX it's up 2%, primarily due to the higher North American volumes.

As expected with the Hitachi consolidation our margins were down to 6.1% versus 6.6% in prior year. But if you adjust out for the negative impact of Hitachi, we're flat year-over-year. I will comment that for the remainder of the year we still are confident that the margins will be in line with the guidance that we provided in December which is a 30 basis points improvement. So, overall, a very solid Q1 for building efficiency.

If we turn to slide 14, Power Solutions, their sales were down 6% compared to last year. But again, if you adjust for FX and impact of the lower lead prices, their sales were actually up 3%. And just to put a little bit of color around the lead prices, the average price in Q1 of this year was $16.81 as compared to $19.99 in the first quarter of last year. And that reduced price of lead finds its way through our top line.

In terms of units, overall first-quarter shipments were up 3% with growth in all regions. America is up 1%, Europe up 8% and Asia was up 7%. As Alex mentioned we had a record million units shipped in the month of December. We continue to see very strong AGM growth with quite honestly demand outpacing our current capacity, and year-over-year volumes are up 41% to 3.2 million units. And we saw strong global volumes with the OEs up 4% and aftermarket up 3%.

Segment income in the quarter was $342 million versus $315 million last year, an increase of 7%, primarily the result of the higher volumes, improved product mix and productivity improvements. The segment margin improvement was 260 basis points, but you really have to look at that exclusive of the impact of the lead. And ex lead it was still up a solid 70 basis points in the quarter. Again Power Solutions just continued to deliver strong quarters for us.

Turning to the automotive business, their sales were down 20% compared to last year. But as Alex mentioned you've got to factor in the deconsolidation of the interiors business with the joint venture that was formed in July of last year and FX. If you consider those two items, sales were actually up 4% on across-the-board strong global production. China sales, which are primarily unconsolidated, as you know, improved 58% in the quarter to $3.3 billion, but that is inclusive of the interiors joint venture. If you strip that out China sales were up 11%; again, very strong performance.

For the quarter segment income of $266 million was up 15% year-over-year, and auto margins of 6.3% were up 180 basis points.

Again we get the benefit of the interiors equity income being picked up with the sales not in the denominator, so if you adjust for that, the automotive business still showed a 70-basis points improvement in the quarter versus last year. So automotive simply continues to deliver excellent results for us.

If I take you to page -- slide 16, overall first-quarter revenues were down 7% to $8.9 billion. As Alex mentioned you really kind and need to unpack that in three pieces. There's just short of $1 billion in interiors revenue that we lost, and then we had headwinds with about $0.5 billion of foreign exchange and then additive to that would be the Hitachi revenues of north of $500 million. If you look at it that way, and exclude those items, you end up that sales were actually up 2% on a consolidated basis and up across all three of our businesses.

Gross margin for the quarter was 18.3%, up 160 basis points, and I think that is really reflective of the benefits that we are continuing to see from the Johnson Controls operating system. SG&A was level with last year. Really the way to look at that is the increases that came from the Hitachi JV were substantially offset by the deconsolidation of interiors and ongoing cost savings and restructuring initiatives that we have across our business.

Equity income was up strong: 37% to $140 million. That's really attributable to two pieces, the Interiors JV which contributed about $20 million in the quarter, and then there were several JVs that came with the Hitachi business, and they contributed between $15 million and $18 million, as well, so that really is the entire gap there. Overall the first quarter segment margins of 8.8% were up 130 bps versus 2015 and 80 basis points excluding the impacts of Hitachi and interiors. So very strong performance as it relates to our segment margins.

On slide 17, net financing charges were pretty level with last year. We did have a slight increase on our effective tax rate from 18.4% to 19%, and there were a few joint ventures that came with the Hitachi transaction that added about $10 million to the minority interest line in the current quarter.

So, overall, we are very pleased with strong first-quarter results and diluted EPS of $0.82, which is up 11% from last year. And I would just echo what Alex said, we're pretty proud of the management teams that were able to deliver these type of results of quarter-to-quarter with all of the portfolio transformation that is really going across the Company and could be potential distractions for us. But it simply hasn't been, and we continue to deliver strong results.

So, quickly, I would like to hit the highlights in the balance sheet. At quarter end we've got a net debt to cap of 39.1% versus the prior quarter of 40.5%, and year-end at 36.7%. And our net debt of $6.7 billion is up from $6 billion at September 30 2015, and if you look at those ratios in the net debt position, it is really a function of the Hitachi investment we made in Q1.

Capital spending at $300 million is in line with expectations and relates primarily, as we've talked in the past, about Power Solutions growth investment. And then cash flow we made some good progress in the quarter. It's normally a cash outflow quarter for us, as you know. It was $300 million in the quarter, which is $100 million better than last year, and we had $100 million of separation costs -- roughly $100 million in the quarter as well. Stronger free cash flow performance this quarter than planned.

So let's turn to guidance on slide 19. For the second quarter we expect earnings per share of $0.80 to $0.83, which would be up 10% to 14% from the prior year level of $0.73. And then consistent with our prior guidance, this will exclude the transaction and separation costs in the second quarter.

And I note that again simply because we expect those costs to ramp up in the second quarter as we move toward a July 1 operational separation date with full legal separation in early October. The other thing we've done on page 19 is lay out for you a chart that shows what our December analyst guidance was for sales growth by business and then our sink margin targets by business for FY16.

I would highlight a couple things. As it relates to BE, we are seeing revenue softness in that business primarily in three areas: China, where it seems to be taking a bit longer to, number one, secure orders and, number two, to get the orders executed from a revenue recognition standpoint. That is causing a bit of softness for us as we look through the rest of the year. The Middle East, although strong in the first quarter, it looks like with oil prices where they are that there could be some softness in the back half of the year.

And the third area that I'd just point to is there were three or four federal jobs, one in particular that we thought the end of the year, FY15 that we were going to secure in early 2016, and for variety of reasons those jobs have not been secured yet. If they aren't secured that will provide a bit of downward pressure on our previously provided guidance as well. Some softness we see in BE as it relates to the 9% to 11%.

In power solutions although unit volume remains strong, the decrease in lead prices that Alex and I have talked about, as well as the FX impact in the year could put a little pressure on the 9% to 11% at Power Solutions. Auto on the other hand continues to be very strong, and we would expect them to exceed the revenue guidance that we provided. As far as margins, despite the top line pressures that we see at BE and Power Solutions, we continue to be committed to that margin improvement, as well as delivering on the $3.70 to $3.90 per share annual target that we provided in December, and that would be 8% to 14% improvement from the $3.42 that we delivered in FY15.

With that, Glen, we can open it up for question.

Glen Ponczak - *Johnson Controls Inc - VP, IR*

Thanks, Brian. Thanks, Alex. Operator, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Robert Barry, Susquehanna

Robert Barry - *Susquehanna Financial Group / SIG - Analyst*

I wanted to follow-up on the comments on commercial HVAC in Asia. In both China and elsewhere it looks like orders were actually pretty good in the quarter, but you also caution that China weakness is kind of weighing on the outlook. Could you maybe unpack a little more of kind of what you are seeing in commercial HVAC in Asia, China and elsewhere?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

I think -- you're right. I caution, because you look across our businesses and just because you asked a question I'll go ahead and answer it. But I will also point out that we really are surprised with the strength in auto and Power Solutions continues to gain share and grow dramatically there in China. But when we look at the buildings business there does seem to be some delays and some stickiness. And it's been pretty lumpy. If you remember, we had a couple quarters we were down. We had a real strong quarter. I think it was fourth quarter sales secured, it's pretty lumpy. I think from our standpoint it's probably just best for us to be cautious. That is why when we talked about our guidance we report on the top line, it's just become pretty hard to predict as it relates to the commercial business.

I would tell you though that one of the real surprises we had I was looking at the Hitachi sales, and our VRF sales through Hisense, our -- it's an unconsolidated joint venture in China, were up dramatically versus our plan. I think it's more of a mix issue, and I think at the high-end infrastructure level some of the commercial projects we're doing moving a little slower than we thought. But our VRF sales are higher than what we expected. I think we're just going to have to continue to watch it. Thank goodness that North American market seems to be kind of chugging along and gaining a little momentum.

You didn't ask the question, but I looked inside our secured for North America, and it's truly institutional. If you look at within the institutional and also commercial which we're seeing some benefit from the CB Richard Ellis relationship. Within commercial and institutional we're seeing that outpace some of the losses that we're seeing within essentially the manufacturing and retail segment.

Robert Barry - *Susquehanna Financial Group / SIG - Analyst*

Got you. Got you. Just sticking with BE on the margin side you talked about seeing improvements in the remaining quarters after some pressure in Q1. Is that just about investment spending moderating or what is driving that?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

As you look -- and I'll let -- get Brian to get in some of the details. If you look at the margins and you get into the new segments, you'll see that our product margins are under pressure and that's where the investments are showing up. I think what our expectation is that we had some costs that won't repeat, but we certainly have reinvested in that business purposely, and you're going to see that pressure. It will get offset, but you'll see that pressure is going to continue to be a little bit on the product side, because that's where the investments show up.

Brian Stief - *Johnson Controls Inc - EVP and CFO*

Rob, I would just add to that if you recall in Q4 we took a pretty good size restructuring charge in BE. And if we look at the timing of those actions, some of those are occurring during the first quarter, and we will just get full run rate benefit for the year in the back half. There is some improvement in margins just a result of the timing of some of the restructuring actions we had.

Robert Barry - *Susquehanna Financial Group / SIG - Analyst*

Got you. And just one last one for me the resumption of the share repurchase, does that add to the EPS target for this year versus what was factored in at the analyst day?

Brian Stief - *Johnson Controls Inc - EVP and CFO*

At analyst day we had an average share outstanding of 652 million. And at that time we indicated we were going to pause it for six months and then reevaluate. We had built into the guidance that we had given that repurchase program coming in for the entire $1 billion in the back six months of the year. Now we are doing $500 million, but instead of doing $1 billion at $50 a share which was what we had built into our plan, we're doing $500 million at $35 a share let's say just to pick a stock price. The net effect of that is about $0.01 or so in the guidance that we gave, Rob.

Robert Barry - *Susquehanna Financial Group / SIG - Analyst*

Got you. It benefits it by one penny?

Brian Stief - *Johnson Controls Inc - EVP and CFO*

Actually, it's the other way, right? Because we had $1 billion in shares at $50 in what we guided, and it's going to be $500 at $35 and the net effect of that is a penny going the other way.

Robert Barry - *Susquehanna Financial Group / SIG - Analyst*

Got you.

Operator

Jonny Wright, Nomura.

Jonny Wright - *Nomura - Analyst*

Just going to the auto side maybe, you guys are actually putting up some strong results despite certainly from some of the investors that we've talked who seem more and more concerned about the auto cycle. I know China's benefiting a little bit from the incentives that have been put in place there. But maybe you can talk about in developed markets what you're seeing, what you're hearing from companies and kind of your outlook for the remainder of 2016.

Bruce McDonald - *Johnson Controls Inc - Vice Chairman and EVP*

Yes. It's Bruce McDonald here. I think if I just sort of run through it regionally, you're right. The incentives that we've put - that got put in place in China that last till the end of the fiscal year have been pretty effective. If you just look at the production throughout our quarter, it accelerated and continues to be pretty strong.

I think there is some question as to whether or not after the Chinese new year is here in early February whether that strength is going to continue. But for now the production schedules that we have for China look pretty good. And I think people are feeling fairly optimistic and probably much more optimistic than people looking outside into China are feeling. The auto sector is doing well in the stock market impact in terms of how widespread that is, is much lower than people think. So I feel pretty good about the outlook for China for the balance of the year probably more so than most people.

In Europe I would say after a long period of soft volumes we are seeing double-digit increases in some of the more mature markets like Spain, France, Italy, the UK, and Germany. Those are holding up pretty well. Our customers are doing better there. A lot of us have taken big restructurings in Europe, and so I think we are positioned well, and you'll have seen that in our margins -- we're positioned well to benefit from the better volumes. I would also point out that in Europe is primarily where all of the luxury vehicles are made for Audi, BMW, Mercedes. And the demand globally for the luxury end is strong and that helps -- that's helping us particularly in our interiors business and seats because there's a lot more content there.

In North America, things are looking pretty good. We're I would say doing better than the industry because of the enhanced content in larger SUVs and pickup trucks, which as you know are sort of hard to keep in stock here right now. I don't think there is a lot of extra growth in the tank for North America this year, but the -- we are seeing a richer mix on larger vehicles, and that will be a good thing for Johnson Controls.

Robert Barry - *Susquehanna Financial Group / SIG - Analyst*

Great. Thanks for that, Bruce. And on Power Solutions, 3% growth excluding FX and the lead impact, I think you guys are looking at close to double digits. But some of the key drivers in that business, you have the China record order -- record shipments in the month, the ATM up 41% -- look pretty robust. Maybe what's different there versus your prior expectation and kind of how do you see that playing for the rest of the year?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

The numbers are so big when you get to Europe and North America. When you start talking about AGM growth at 41% in China being record sales. It doesn't -- we can't get to the 9% to 10% without both mix and growth within primarily North America, and that's really where we need to see it.

I think that -- I think that we feel good about where things are, but it's a little bit out of our control. Particularly when you start talking about aftermarket and what the weather's going to be and what the timing of that is going to be, but that's what moves the needle when you look at North America.

I think we feel like we are in good position. A lot of it has to do with what our customers are seeing. We're not going to -- we're not in a position that were going to gain any more share in North America. What we really need to see is some -- we need to see the weather help us out here a little bit.

Jonny Wright - *Nomura - Analyst*

Okay. Brian, reported free cash flow this year is $1 billion still the target?

Brian Stief - *Johnson Controls Inc - EVP and CFO*

Yes. The guidance has not changed.

Jonny Wright - *Nomura - Analyst*

Great. Thanks guys.

Operator

Julian Mitchell, Credit Suisse

Julian Mitchell - *Credit Suisse - Analyst*

Hi, good morning. Just first the question on pricing within building efficiency. I guess firstly around -- you talked about some of the private sector commercial activity maybe being a bit uneven. Have you seen any change in the ability of HVAC manufacturers to price? And also on your margins what sort of affect do you see for price net of cost this year in BE?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

You're talking about based on commodities?

Julian Mitchell - *Credit Suisse - Analyst*

Yes. And your pricing net of commodity costs.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

I actually don't have that in front of me. I will have to get back with you and make sure I understand our net hedge position primarily around copper. We certainly are seeing some help as it relates to our transportation costs, but I don't have an update on that.

We will follow up on that specifically just so I don't misrepresent it. As it relates to pricing, I was talking to Bill Jackson, our president at Building Efficiency, and he seems to feel pretty good that pricing has not been -- that pricing has been rational. And probably because we're starting to see orders increase a little bit that we are not under as much pressure particularly in North America. I think the opposite is the truth when you get to places like China, though. I think there's some pricing pressure in China.

Julian Mitchell - *Credit Suisse - Analyst*

Understood. Thanks. And just on Hitachi, you highlighted that it's off to a good start on growth as well as perhaps margins. I just wondered when you look at that business right now how you think about the priorities there in terms of maximizing say VRF growth in the US versus making sure that you can pull up the margins through cost synergies. And maybe how much higher do you think you can push those margins at Hitachi over the next couple of years.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

I think if you want to -- if you were going after the most important things and strategically we need to be able to get our position strengthened in North America in VRF, because we are going to market now, Hitachi wasn't in the market. So I think that strategically is going to be important.

As it relates to margins, our biggest lever on margins is going to be the business that's in Brazil and the business that's in Japan and our Iraq business which is the residential business. And that's going to be more around cost than it is going to be around growth. There's really two answers. One in the long-term, it's going to be very important for us to continue in investing. If you looked inside we should see we are investing in our distribution and investing in places like North America to set up our channels and our training and our support system. And then if you look at our cost plan, it really is around our residential business and focused in Japan and Brazil.

Julian Mitchell - *Credit Suisse - Analyst*

Very helpful. Thank you.

Brian Stief - *Johnson Controls Inc - EVP and CFO*

On the commodity question just to address that quickly, I do have some data here. As it relates to BE in the quarter, we did get a commodity benefit of about $3 million to $3.5 million in the quarter, and we are forecasting for the year that that number could be around $14 million. But based upon current FX levels across the two or three main countries that they do business in that are impacted negatively, it's pretty much offset as it relates to our plan. There is really no commodity benefit net net coming through if you consider FX as well.

Julian Mitchell - *Credit Suisse - Analyst*

Okay. Thank you.

Operator

Mike Wood, Macquarie.

Mike Wood - *Macquarie Research - Analyst*

First, are Hitachi sales still expected to be about $3 billion for the full year, and is the lower run rate in fiscal first quarter just seasonality, or is there something else there?

Brian Stief - *Johnson Controls Inc - EVP and CFO*

So a couple things there. The first quarter was $525 million. And it is seasonal to some extent. I would tell you that we had guided at about $3 billion sales and $120 million a sync and in that $3 billion in sales there was an entity that's got about $250 million of sales that we were planning on consolidating. And as we got in and looked at the underlying agreements related to the joint venture itself, we determined from an accounting standpoint that we weren't going to be able to consolidate that entity.

So instead of $3 billion for the year our revenues related to Hitachi are going to be $2.75 billion or so. That correspondingly there was about $70 million in the quarter that was impacted as well. That $525 million was originally targeted to be about $600 million. We are now looking at Hitachi for the year about $2.75 billion, and yes the $525 million in the first quarter reflects some seasonality in that business.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

I would like to point out that the strong [exposed] we saw in China is an unconsolidated. So if you look at the top-line growth, where we had the strongest sales, it happens to be and where we saw the strength in China representing earlier it happens to be with Hisense which is unconsolidated.

Mike Wood - *Macquarie Research - Analyst*

Great and approximately when should we expect to begin to see benefits of the restructuring in that resi business that you were planning?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

That's a great question. I think that the next time we get together I will be able to update. In fact, we had a -- I will be at a steering committee tonight, so I will be able to report on that. I will -- I am anxious to be able to tell you what the plan is, but I want to make sure that I get it hot off the press

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Mike Wood - *Macquarie Research - Analyst*

Great. Thank you.

Operator

Josh Pokrzywinski, Buckingham Research.

Josh Pokrzywinski - *Buckingham Research - Analyst*

Just to follow up on some of the BE order momentum and maybe unpacking that growth algorithm to 10% --

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Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

I'm sorry, we can't hear you.

Josh Pokrzywinski - *Buckingham Research - Analyst*

Just to come back to that 10% outlook for BE, obviously some puts and takes internationally, and it sounds like the bottom line is North America is still pretty solid. I guess, Alex, how do you think about North America underneath that 10%, and where does the bridge from here really need to get better to start to move closer to that? Maybe the 10% number is more aspirational just given where we started, but what needs to get better or still from here to start looking more achievable?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

If we continue to see the kind of momentum we have in the quarter, particularly the end of quarter, I think that at some point -- in North America, I think we that can get there. I get -- I just get a little bit nervous about things that are outside of our control. It seems like the actual market is doing better than the financial markets, but at some point the financial markets will make their way to the investors and that -- investments, and that worries me.

I'm pretty bullish on what I see in North America with one caveat is that there is this cloud hanging around as it relates to the financial markets. It's -- what you hope is it doesn't get our customers spooked as it relates to investments. The institutional markets are gaining steam which is our strength. Knock on wood, I'm hopeful to be able to report that we will continue to see that growth.

Unfortunately the one thing that we were counting on that did not come back -- at least did not come back at the pace we wanted was if you remember we got sidetracked at the end of Q4 with the federal government work. It was huge projects, and a lot of them and we've significant -- we had significant impact to our backlog and to our top line because of that. And we haven't seen that come back. Hopefully we will see it at the end of this year when it comes to that time again, but it's always been something we can count on, and I'm just not sure if we can count on it now or not.

Josh Pokrzywinski - *Buckingham Research - Analyst*

Would that branch business look even stronger ex government this quarter?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

Absolutely. The federal government -- in fact earlier when I said that, I apologize, I said something about industrial -- industrial and federal government together are the two ones that are off. Not only where our backlog is, but we've seen it continue through the second quarter.

Brian Stief - *Johnson Controls Inc - EVP and CFO*

Just to put it in perspective the government jobs that I referred to that are really out there that we are not sure if they're going to now be able to execute or even if they will be awarded to JCI given some of the referrals that are going on are in the $125 million to $150 million range in aggregate. So that certainly is a piece of the issue we need to work through for the rest of the year here.

Josh Pokrzywinski - *Buckingham Research - Analyst*

Got you. As I think about how that 10% broke down initially in December it seemed like there were -- I'm recalling it right about maybe three or four points of products -- new product growth and channel penetration. How do you market yourself against that bogey today, on track or is there maybe a bit of a gap there too?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

There's a gap there. When you talk to the teams -- there's two things that -- when you look at the new segments you will be able to see that. The product growth wasn't what we expected and the margins because the investments were a little lower.

One of the things that was a challenge for us in the first quarter was that when we were going through the integration of ADTI, one of our brands -- our significant brands -- we relocated one of the production facilities, and I think we had a hard time catching up with deliveries. So, hopefully that will fix itself a little bit. That was one of the problems we had in the quarter.

Brian Stief - *Johnson Controls Inc - EVP and CFO*

I think with some of the product investments that we made in the first quarter hopefully we'll start to see some of that benefit in the back half of this year. Just to kind of frame that for you, between product investments and investments in sales resources that number was almost $20 million in the quarter for BE, and you'll see that when you see the products North America segment data that's in the 8-K. Okay. That's helpful.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

The other thing that this kind of a -- to kind of pile on a little bit, the Hitachi channel work will show up in that number, too, which was -- which is an investment that we have to put in place in order to get ready for the sales for that particular product. There was a significant amount of investments in the product North America business.

Josh Pokrzywinski - *Buckingham Research - Analyst*

Okay. And just flipping over to Adient real quickly, it might be a little premature for this. I'll take a flyer. I guess with the new structure with Tyco one would imagine that Adient comes out maybe a bit more tax advantaged than it would have otherwise pre-merger. Anyway to maybe handicap what kind of tax synergies maybe versus the former imaginary case --

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Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

It's a great question. It's really good question and I think as we work through that we've talked about where we are and we just haven't -- we just don't have it finally worked out. We will have it worked out by the time we get the Form 10 and the question you have is a great question. And I think we are sorting through that now, and we certainly will have that prepared between now and the Form 10 and so at the latest we will be able to have that then which is late March or early April. Good question.

Operator

Colin Langan, UBS.

Colin Langan - *UBS - Analyst*

Can I just clarify - I just want to understand the power solution outlook -- if we take out the impact of lead prices, does the outlook on your -- for that segment actually really change? Is the sales -- that's creating a sales headwind, but dollar margins seem like they're going to look better on a percentage basis, or is there some other underlying headwind there that we should also be considering.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

That's the way should think about this business. One of things we wanted to make sure that we pointed out is don't give us all the credit for the 260 basis points of margin improvement, because that's not all operational, because as things move around we may not be able to continue at that level. That's why we point that out. That we are -- because lead's such a big part of that pass through that it does impact our margin. But you got it right. As lead prices go down the margins go up. It doesn't impact us -- there is a timing issue that flows through our books. But other than timing it's kind of a net zero fact dollars wise.

Colin Langan - *UBS - Analyst*

In terms of the outlook for Building Efficiency sales being at risk, you named three items, you quantified some like the federal jobs are maybe 1% of your growth. If all of those items are issues what is sort of the bare case that you are looking at for that from that 9% to 11%? How bad do you think it will get if all of them come together at the same time.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

Probably half that number. I think that's probably what we see now. I guess it could get worse, but if we see the -- kind of if you look at where we are, when we talked about it our backlog is actually down going into the year because of the federal government work. So what you have to -- what gets a little bit difficult to predict is if the product business doesn't grow then we are really suspect to the revenue recognition of needing a backlog and the flow through of the work. Even if we are secured starts moving at the rate it's been growing at we will still have a revenue issue, so we need to get those orders in now.

Colin Langan - *UBS - Analyst*

Okay.

Brian Stief - *Johnson Controls Inc - EVP and CFO*

But I would tell you we've got a contingency plan as it relates to it if that were to happen. We've got actions that we can take to ensure that we still deliver the segment income and the margins and what we've kind of put out there for our full-year guidance. We're working the issue relative to top line and adjusting our cost structure accordingly.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

Absolutely, so our investments will certainly mirror our top line prospects. We're -- we have not changed our commitment regardless of where we fit in the revenue as it relates to our bottom line. The other part of this is it's not like you can't see it coming as it relates to revenue. If our backlog doesn't improve we certainly are not going to be able to make the investments as quickly as we planned.

Colin Langan - *UBS - Analyst*

Thank you very much.

Operator

Rod Lache, Deutsche Bank

Patrick Nolan - *Deutsche Bank - Analyst*

Good morning, everyone, it's Patrick Nolan on for Rod. Just a similar question on Power Solutions the organic growth, the 9% to 11%. I know it's not the biggest quarter this quarter but how are you -- if things are tracking pretty much in line with what you're seeing at the end of the quarter, where do you think that 9% to 11% ends up for the year? And just a housekeeping. What was the actual revenue impact from lead in the quarter?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

Revenue impact on lead?

Brian Stief - *Johnson Controls Inc - EVP and CFO*

Revenue impact on lead was about [$50 million] in the quarter. And as far as where the 9% to 11% could go, I guess based upon what we've seen, could go down to 7% to 8%? Yes, but again I would tell you if it goes down to that level, we've got plans in place to cover. So at this point in time whatever shortfall we might see in BE and power we think auto is over performing, so we are very comfortable with where we are for full-year guidance.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

And remember as a relates to any of the lead impact of top line is not something that we should feel from a bottom-line perspective.

Patrick Nolan - *Deutsche Bank - Analyst*

Thanks guys.

Glen Ponczak - *Johnson Controls Inc - VP, IR*

Operator we have time for one more.

Operator

Noah Kaye, Oppenheimer

Noah Kaye - *Oppenheimer & Co. - Analyst*

With the Tyco merger now another major integration to manage, I'm just wondering how, if at all, does that change your thinking about the capital allocation strategy once all of these ducks are put in a row?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

Do you mean as it relates to after?

Noah Kaye - *Oppenheimer & Co. - Analyst*

Yes after the spinoff and the dividend receipt, the influx of cash, how could all of this change any of your thinking about capital allocation say between M&A, share repurchase --

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Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

I don't know that it changes anything except that we are going to have an awful lot going on. Depending on where we are -- if you look at the cash flows that we look at it's going to ramp up because we will still have some trailing costs as it relates integration, moving into next year even the separation. So I think as our cash flows improve, depending on where we are with integration, I would expect that we're going to make the right decision as it relates to whether we return that to the shareholders or make investments.

I don't know that we've gotten that far, but the one thing I can tell you for sure is around our dividend policy we're both -- at this point we're both committed to making sure that at a minimum we continue the current dividend policies of both companies. But we have to -- just make sure that you understand where we are in the process. There's an awful lot of the stuff that we really have to continue to work through. We haven't really had a lot of those conversations yet as a team. But we're going to have (multiple speakers) have to take cash flow. That's for sure.

Noah Kaye - *Oppenheimer & Co. - Analyst*

If I have time for one quick follow-up just to come back to Power Solutions and specifically to AGM, 41% growth in shipments. Maybe at a high-level could you talk about your level of let's call it medium-term visibility over the next few years, you're significantly expanding capacity. How much of that visibility related to design ins and customer commitments and what's sort of the right mix of aftermarket versus OE to think about?

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

Great question. It's still going to be a lot more OE than aftermarket, because the OE business is growing so fast. And our visibility to that is pretty high, because usually it's program driven. A lot of the AGM capacity we're talking about adding has been in China. But what we're seeing is across the board. We'll be adding capacity in Europe, a lot of that because the aftermarket is starting happen there, because we've been at it much longer. In North America there is actually more than aftermarket that's already there surprisingly. It's not necessarily for start stop. It's just for enhanced performance. In China it's really an OE story. I think is still going to be a heavy mix for OE, and I think what we see is that most of the capacity, if not almost all of it, is already subscribed that we're putting in.

Noah Kaye - *Oppenheimer & Co. - Analyst*

Excellent. Thank you.

Alex Molinaroli - *Johnson Controls Inc - Chairman & CEO*

Let me close out. I just want to comment again, and I'm not sure if you were sitting in my shoes how you couldn't feel good about the ongoing performance of the business. We continue to meet the expectations that we set not only as an overall business but within the segments. We continue to improve our margins, and I think our investments particularly in BE we're starting to see the shoots of growth, and I am pretty proud of all of that that everyone is accomplishing. Hopefully you feel the same way that I do that our strategic position is improving. I think Adient is going to be an incredible competitor within the automotive space, and we're setting it up to be successful. That's our plan.

If you look at the remaining Johnson Controls not only the investments we're making now but you look at the transformational merger that we talked about, we have an opportunity to do something really special. I think that we will actualize that. Hopefully you have the same confidence I have, and we look forward to continue reporting, achieving our near-term and our long-term plan. Thanks a lot. Have a great day.

Brian Stief - *Johnson Controls Inc - EVP and CFO*

Thanks everybody.

Operator

Thank you and that concludes today's conference. Thank you all for participating.