05-May-2023

Johnson Controls International Plc (JCI)

Q2 2023 Earnings Call

CORPORATE PARTICIPANTS

Jim C. Lucas
Vice President-Investor Relations, Johnson Controls

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

OTHER PARTICIPANTS

Nigel Coe
Analyst, Wolfe Research LLC

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Scott Reed Davis
Analyst, Melius Research LLC

Chris Snyder
Analyst, UBS Securities LLC

Julian Mitchell
Analyst, Barclays Capital, Inc.

Joseph O'Dea
Analyst, Wells Fargo

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Deane Dray
Analyst, RBC Capital Markets LLC

Gautam Khanna
Analyst, Cowen & Co. LLC

Brett Linzey
Analyst, Mizuho Securities USA LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Johnson Controls second quarter 2023 earnings conference call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, today's event is being recorded.

I would now like to turn the conference over to Jim Lucas, Vice President, Investor Relations. Please go ahead.

Jim C. Lucas

Vice President-Investor Relations, Johnson Controls

Good morning and thank you for joining our conference call to discuss Johnson Controls' second quarter fiscal 2023 results. The press release and all related tables issued earlier this morning as well as the conference call slide presentation can be found on the Investor Relations portion of our website at johnsoncontrols.com.

Joining me on the call today are Johnson Controls' Chairman and Chief Executive Officer, George Oliver; and Chief Financial Officer, Olivier Leonetti.

Before we begin, let me remind you that during our presentation today we will make forward-looking statements. Listeners are cautioned that these statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of Johnson Controls. These risks and uncertainties can cause actual results to differ materially from our current expectations. We advise listeners to carefully review the risk factors and cautionary statements in our most recent Form 10-Q, Form 10-K, and today's release.

We will also reference certain non-GAAP measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are contained in the schedules attached to our press release and in the appendix to this presentation, both of which can be found on the Investor Relations section of Johnson Controls' website.

I will now turn the call over to George.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Thanks, Jim, and good morning, everyone. Thank you for joining us on the call today.

Let's begin with slide 3. We are proud of our second quarter performance, which saw sales, segment EBITA, and adjusted EPS all exceeding the high end of our guidance. During the quarter, sales grew 13% organically, as we realized strong pricing and improved volumes across both our shorter-cycle Global Products and longer-cycle Business Solutions (sic) [Building Solutions].

The overall demand backdrop remains robust, with orders growing 8% for Business Solutions (sic) [Building Solutions] and continued momentum with service orders growing 14% in the quarter as the adoption of our digitally enhanced solutions continues to materialize and provide value for our customers.

Our resilient backlog grew 9% to a record $11.7 billion, and our service backlog increased by 15%. We made great progress executing on our higher-margin backlog build and continued to convert at a faster pace, resulting in improved gross margin performance and strong incrementals.

In addition, we realized $75 million in productivity savings and are on track to meet our targets of delivering $340 million in savings for the full year. As a result, adjusted segment EBITA margins expanded 120 basis points. As we move into the second half of the fiscal year, our strategy remains sound as we continue to execute our resilient backlog, deliver on our productivity initiatives, and advance our digital transformation.

Our pipeline remains healthy, and we expect momentum to stay positive. While global macro conditions remain uncertain, we are confident in the fundamentals we have built across our business.

Our visibility into the second half of the year provides confidence in raising the lower end of our full-year adjusted EPS guide, which Olivier will provide more details on later in the call. We continue to anticipate strong top line growth and backlog conversion in the second half, which should lead to continued margin expansion.

Now turning to slide 4, we continue to demonstrate our unique value proposition and accelerated our leading position through our pillars of growth. We have a significant market opportunity ahead of us connecting smart, healthy, and sustainable buildings. As the call for climate action intensifies, we are seeing strong tailwinds for our sustainability, infrastructure, and decarbonization offerings.

As we have stated in the past, nearly 40% of global energy emissions come from buildings. At Johnson Controls, we play a vital role in helping our customers bridge the gap towards a net zero future.

Our systematic approach to digitization is creating a new class of smart buildings, helping reduce energy emissions, improve efficiency, and optimize costs. We are well positioned to capture secular trends to help build towards a more sustainable future.

OpenBlue is a key differentiator as we advance our leadership position across our vectors of growth. Last quarter, we highlighted the significant progress through our digital transformation journey, and today we continue to see increased adoption of our OpenBlue platform across multiple use cases.

By combining our dynamic product portfolio and services, we are making significant progress in expanding our global footprint of smart Building Solutions, helping better serve our direct channels through real-time monitoring of connected devices. Our integrated domain expertise and unique capabilities set us apart, and we look to continue this momentum as we help our customers deliver their objectives.

While we continue to scale and capitalize on these emerging opportunities, we remain committed to building on our strong operational foundation and further expanding our margin profile. We have made great strides in successfully navigating inflationary headwinds and supply chain constraints over the year. As these have eased, our ability to execute is important. We see the results through our progress with our suppliers, disciplined pricing approach, and delivering on our productivity savings plan.

Lastly, we look to maintain our prudent approach to capital allocation and drive long-term shareholder value through our attractive dividend growing in line with net income, as well as consistent share repurchases. Year to date, we have returned over $700 million in capital, including roughly $250 million in share repurchases and nearly $500 million in cash dividends.

Moving on to slide 5, there has been a lot of focus the past couple of months around commercial construction, particularly with regards to the commercial office sector. While Johnson Controls does have exposure to this sector, it represents a small portion of our overall business. In addition, we have a large installed base, and there continues to be demand for retrofit projects.

This slide highlights the overall diversity of the Johnson Controls portfolio. Within commercial, we are diversified with exposure from retail, lodging and hospitality, sports and entertainment, to warehouses. Beyond commercial, we have a broader exposure to institutional, industrial data centers, and government sectors.

Funding both for new construction and especially retrofit comes from many different avenues. There remains a lot of pent-up stimulus funds in both the US and Europe that have not yet been released. We have a strong backlog today and we continue to see a long runway for growth as we leverage our broad portfolio of products and solutions.

In addition to our diversification of the verticals we serve, a key differentiator of our portfolio is the ability to leverage our large global installed base of equipment. As we further digitize our offerings to create smart connections, we can create more predictive outcomes for our customers as we help them use the power of data to make net zero a reality.

On to slide 6, service is a key area of focus for us as we leverage our large installed base. We once again saw strong double-digit growth in sales and orders. We are making tremendous progress in taking what has historically been a mechanical break-and-fix business in building a solutions-based business that creates a higher margin recurring revenue stream from our large installed base.

As we create more predictive outcomes, it not only helps our customers achieve better results, but it also allows us to better leverage our global field operations more effectively. We are creating more standardization across our field operations and capturing better data from our connected solutions. As a result, our higher margin parts business grew over 20% in the quarter, and we see this as a growth contributor to our overall service strategy.

Decarbonization is an area of focus across the entire Johnson Controls portfolio, which includes our sustainable infrastructure, or SI business, that the KPIs on this slide represent. In addition to SI, decarbonization touches many products and solutions. Nearly 55% of our products and solutions drive sustainability. This includes heat pumps, energy efficient refrigerants, and digital solutions, to name just a few. As an example, when we upgrade an asset or a solution in the field, it drives efficiency at the building level, such as software for controls or upgrading a chiller.

Within SI specifically, we continue to see strong orders, revenue growth, and a very healthy pipeline. The healthy buildings market opportunity remains strong, as evident by our almost $2 billion pipeline. We are seeing increased traction among both federal and international regulators as productivity benefits associated with well-managed indoor environments come to the forefront.

Recently, the European Parliament voted to include a promising enhancement to the Energy Performance of Buildings Directive, which would require indoor environmental quality monitoring of buildings.

Johnson Controls is encouraged by the latest developments as the IEQ language has the potential to drive increased adoption of digital building systems and deliver improved health and wellness, all while accelerating the decarbonization of buildings.

Turning to slide 7, we are honored to be continually recognized for our dedicated sustainability efforts. During the quarter, we received several recognitions, including being named one of the World's Most Ethical Companies for the 16th time by Ethisphere.

We were especially honored to be named to the Clean200 for the 8th consecutive year. Every year, 200 out of more than 6,000 companies are selected for the high proportion of their revenue earned through sustainable business. We are proud of the recognition and will continue to further our strategy to help tackle building emissions globally.

I will now turn the call over to Olivier to go through the financial details of the quarter.

Olivier?

Olivier Leonetti

Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

Thanks, George, and good morning, everyone.

Let me start with the summary on slide 8. Total sales grew 10%, while organic sales increased 13% with strong double-digit growth across each of the segments. Price contributed 10% during the quarter, and volumes were up 3%, which was offset by a 3% FX headwind. Adjusted segment EBITA increased 20% with margin expanding 120 basis points to 13.8%. Price/cost was positive, and we delivered strong productivity.

Turning to our EPS bridge on slide 9, adjusted EPS of $0.75 was favorable to the high end of our guidance by $0.01 and increased 19% year-over-year. Operations contributed $0.12 of the growth in the quarter as price/cost continued to gain momentum and we saw good drop-through on our improved volume. Our SG&A and COGS initiatives delivered $0.09 of growth.

Below the line, we did see headwinds from non-recurring corporate items, FX, and net financing costs. On the whole, we were pleased with the strong adjusted EPS performance in the second quarter.

Let's now discuss our segment results in more details on slides 10 through 13.

Beginning on slide 10, organic sales in our shorter cycle Global Products business increased 12% in the quarter, benefiting from strong price realization of 9% and 3% volume growth. We saw strong growth across most of the portfolio led by greater than 20% growth in commercial HVAC. This growth occurred in both applied and light commercial where demand remains strong.

Global residential declined low-single digits as moderate growth in the rest of the world partially offset high-teens decline in North America. This was a continuation of channel inventory being reset, which we will expect to continue for another quarter or two.

Fire & Security grew low-double-digits with continued momentum within our fire detection products. Industrial Refrigeration also experienced double-digit growth in the quarter, driven by solid growth in both North America and EMEA/LA. Adjusted segment EBITA margins expanded 250 basis points to 18.6% as price/costs continued to improve and productivity was positive.

Moving to slide 12 to discuss our Building Solutions performance, orders increased 8% organically as China rebounded from COVID-related impacts during the first quarter. We saw healthy growth in install orders of 5% and were especially pleased with service orders growing 14%. Our focus and investment around increasing our service offering continues to gain momentum.

Total sales grew 11% with organic sales increasing 13%, made up 10% price and 3% volume growth. Service revenue grew 11%, and install revenue increased 15%. Adjusted segment EBITA increased 16% with margins expanding 50 basis points, led by positive price/cost and improved productivity. Building Solutions' backlog remain at record levels, growing 9% to $11.7 billion. Service backlog grew 15%, while install backlog increased 8%.

Let's discuss the Building Solutions' performance by region on slide 13. Orders in North America increased 8% with strong growth in our government and manufacturing sectors. Service orders grew 14% with double-digit growth in both recurring and non-recurring contracts. Overall, demand continues for HVAC & Controls, which grew high-single digits within the quarter. In aggregate, Fire & Security orders grew mid-single digits.

Sales in North America were up 14% organically with broad-based growth across the portfolio. Our install business grew 17% with strong growth in both retrofit and new construction, which grew 15% and 20%, respectively. Service continues to perform well, up 9% year-over-year with high-teen growth in our shorter cycle transactional business. HVAC & Controls remain a strong part of the portfolio, growing high-teens year-over-year, while Fire & Security increased low-double-digits.

Segment margins expanded 190 basis points year-over-year to 12.5%, driven by ongoing productivity benefits and the execution of higher margin backlog resulting in positive price/cost. Total backlog ended the quarter at $7.7 billion, up 13% year-over-year.

In EMEA/LA, orders were up 7% led by mid-teens growth in Industrial Refrigeration and mid-single-digits and low-single digit growth across our Fire & Security and HVAC & Controls platforms, respectively. On the whole, service orders grew 13% led by double-digit growth in our recurring plan service agreements primarily in security.

By region, we saw strong double-digit growth in both Middle East, Africa, and Latin America. Sales in EMEA/LA grew 12% organically with strong low double-digits growth in both service and install.

Our shorter cycle transactional business was the main contributor to the overall service growth, with our recurring plan service agreements reporting solid growth of low-double-digits. Overall, momentum continues to build within applied commercial HVAC and Fire & Security where each contributed to mid-teens growth within the quarter.

Segment EBITA margins declined 270 basis points to 6.7% as headwinds from non-recurring items offset operational improvements year-over-year. Backlog was up 5% year-over-year to $2.3 billion.

In Asia-Pacific, orders grew 9% with 20% growth in service led by strong growth in our shorter cycle transactional business. Overall, install orders grew 6% organically. By region, China recovered from COVID-related lockdowns in Q1 with strong growth of greater than 30% in the second quarter.

Sales in Asia-Pacific increased 15% with strong mid-teens growth in both service and install. Overall, commercial HVAC & Controls grew high-teens, while Fire & Security declined low-single digits.

China gained momentum as the country continued to reopen during the quarter with strong sales growth of 16%, which included double-digit growth in both service and install. We expect continued recovery with a solid second half performance in China.

Segment EBITA margins declined 10 basis points to 11.8% as positive price/cost was offset by FX headwinds over the quarter. Backlog of $1.7 billion declined 3% year-over-year.

Turning to our balance sheet and cash flow on slide 14. We ended the second quarter with $2 billion in available cash and net debt remained at 2.2 times, which is within our long term target range of 2 times to 2.5 times. Free cash flow turned positive in the quarter as anticipated. Inventory improved sequentially, and free cash flow remains a major focus with inventory being a driver to further improvement in the second half.

Now let's discuss our fiscal year 2023 guidance on slide 15. We're introducing third quarter organic sales guidance of approximately 10% as price continues to be a strong contributor. For the third quarter, we expect segment EBITA margin to expand 120 to 130 basis points and adjusted EPS to be in the range of $1.01 to $1.03, which represents a year-over-year growth of 18% to 21%.

On the full year, we are once again raising the lower end of the wide range introduced at the beginning of the year. Our new adjusted EPS range reflects what has been at the top of the range we had discussed as a base case the last two quarters. Our full year adjusted EPS guidance range is now $3.50 to $3.60, representing growth of 17% to 20%.

On the top line, we anticipate organic sales to grow approximately 10% for the full year. We now expect segment EBITA margins to expand 100 to 120 basis points, as we continue to execute on fulfilling our higher margin backlog. We expect full year free cash flow conversion to be 80% to 90%, recognizing that second half free cash flow will be driven by inventory reduction.

We are pleased with our first half performance and see solid momentum entering the back half of the year. Our pipeline remains robust across all our vector of growth, and our productivity initiatives remain on track.

With that, operator, please open up the lines for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And today's first question comes from Nigel Coe with Wolfe Research. Please go ahead.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning, everyone.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Good morning, Nigel.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks for the question. So you guys are the last one, so good to finish on a pretty good high here. So on the price/cost, I really appreciate the extra disclosure around this, $170 million for the quarter, roughly half of that in Global Products. Any sense or any kind of color on how that price/cost tailwind looks in 3Q and 4Q?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Thank you for your question. Price/cost will remain positive, of course, in dollar and rate for the second half of the year as we keep materializing the strong margin backlog we have in the P&L.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

In addition to that...

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. But no – yeah.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

...when you look [indiscernible] (00:23:27) business, what you see happening is all the work that we did through the course of last year, building a very strong backlog with very strong margins. As you see, as we begin to turn that, we're seeing a nice pickup in the margin rate, which is exactly what we expected.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. But no hard disclosure around price/cost, okay. And then on the pie chart of the exposure, I thought that was really helpful. So roughly 20% commercial. Obviously that includes service, renovation, and new build. So if we were to distill this down to just the commercial office new builds, what the message here is like low single-digit exposure to commercial office new builds. And so if you can just maybe comment on that?

And then thinking about the exposure to regional bank lending, when you look around that pie chart, where do you see the exposures over and above commercial office?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Nigel, let me touch upon the commercial exposure. I think it's important to understand the secular trends that are well underway within our sector around sustainability, healthy buildings, and digital. And I think the value proposition that we're bringing to ultimately address these issues do play out across all of the verticals that we support.

Now, when you look at the commercial sector, we typically are 50% new build and 50% retrofit. And so we're still seeing very strong not only the conversion of the new build that has been started, but we're seeing a pickup of opportunities as we're retrofitting that space now with digital, with upgrading equipment, as well as then now focusing on outcomes that we can create now leveraging the connectivity that we have in the building, the data that we extract, and then using that data to reduce energy consumed and just overall efficiency of the building.

So I think right now, even though that's been a concern, as far as the overall pipeline that we're developing around is still very strong. And we stay focused on how we differentiate and ultimately then deliver on the challenges that our customers are facing.

Relative to the banks, maybe, Olivier, you can share your thoughts.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

So as we put in George's prepared remarks, we have a low exposure to the office business. Your number is in the ballpark, Nigel. Our customers also have many funding sources, so we don't see today an exposure to what is happening in the US in the banking industry.

Another data point, as George indicated, the backlog is strong and very resilient, which is another indicator about the strength of the financing sources.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Right. Okay, I'll leave it there. Thanks a lot, guys.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Thank you.

Operator: Thank you. Our next question today comes from Jeff Sprague with Vertical Research. Please go ahead.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Hey, Jeff.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Thanks. Good morning, everyone. Hey. Good morning. These service orders look borderline fantastic actually. I'm wondering if you could provide a little bit more color on the composition. Obviously, you introduced the call with highlighting some of the secular things that you put in place. But when we think about, for example, North America service orders up 14%, should we think of that as driven by existing customers who are taking more of your upsell? Is that the primary driver, or is this a recapture of installed base that maybe you weren't serving before? I'm sure it's a lot of different things, but I just wonder if you could kind of characterize maybe the key drivers there.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Jeff, let me lay out the fundamentals of our service business. Historically, it has been a mechanical break/fix business. And as we've been transforming the company with digital, going back and making sure that all of our installed base is connected, we ultimately then use the data to not only enhance the traditional services that we perform, but then add on additional value propositions with energy and space utilization. There's a lot of things that we can do with now the capabilities of OpenBlue. And then ultimately, with that, we get better value propositions and better delivery. Our attrition comes down, and then ultimately, we believe we can sustain double-digit growth with that model.

When you look at the quarter, we were up 11% revenue growth, like we said, 14% orders. But the underlying to your question, when you look at connected chillers, we're up 100% year on year. We're up almost 14,000 chillers that are connected, that real time are collecting data. We're performing a service, and then we're ultimately creating new opportunities on top of that with additional revenue.

And then when you have these agreements in place, you get significant pickup on additional service beyond just the contract that we have. So our PSAs, when we talk about performance service contracts, we're up double digit. And that's increasing our recurring revenue base on a forward-looking basis that we're going to be able to achieve being able to support those customers.

And so when you look at the service business – and then the last thing we highlighted is when you do that with the insights that we're creating, we can create predictive events, which ultimately drive upgrades predictively versus reactively, that ultimately generates businesses.

So our parts business is up well over 20% year on year as a result of the work we're doing. So it really takes everything we've been talking about as far as mining the installed base. Our connectivity to the installed base, we're up over 600 basis points since Investor Day and in the quarter 146 basis points year on year. And so that is creating the base that we ultimately then go create new value propositions, supporting our customers, especially along the lines of these secular trends.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Great, thanks for that. And then just on Europe and Corporate, it sounds like you took a couple hits that you just digested and moved on. Can you give us some sense of what these were, how large they were, and if they are kind of truly non-recurring in nature?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc
A

Absolutely. So for EMEA/LA, the fundamental of the business is the same as for the Field business, meaning we have accumulated rich margin orders in the backlog, and those rich margin orders are today being realized in the P&L. We don't see them yet in EMEA/LA, because we had some non-recurring items.

Two things, we had last year some tax credits, which are not being reproduced. They're tax items, which are above the line. And we have this year also some UK pension one-off cost, which are impacting the EMEA/LA performance. We expect the EMEA/LA performance to increase sequentially in Q3 by a sizable amount, and we expect EMEA/LA performance in Q3 year on year to be about flat. So that's for EMEA/LA.

For Corporate, no structural increase to our costs in corporate, again, some one-offs, which were good last year for about $20 million, some one-offs this year, which are impacting negatively our P&L. It's a range of items, but no recurring increase in corporate costs.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

Great, thanks. I'll leave it there.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc
A

Thank you.

Operator: Thank you. And our next question today comes from Steve Tusa with JPMorgan. Please go ahead.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Hi, good morning.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc
A

Good morning, Steve.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc
A

Good morning.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Just on the answer to Nigel's question, just to be clear, that commercial, that's your total revenue. So there's also global exposure outside of the US. And you mentioned 50:50 split between retrofit and new, that obviously does not include services as well, you were talking about the equipment split there?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc
A

Steve, when we look at our revenues, that takes into everything we do within those verticals for the company, including our Global Products business and then the Field business, both install and service. Through cycles, the new construction goes down, the service and retrofit goes up. But as we've been now capitalizing on the opportunities with the new service offerings that we have, we are seeing a natural pickup of additional retrofit because of that, along the lines of these secular trends.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. And then just lastly on the EMEA/LA margins, can you maybe talk about the timing of price/cost coming through there? Regionally, is there any kind of lag or lead relative to the inflection you're now seeing in North America?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

We should see the margin to pick up, Steve, in Q3 sequentially by more than 2 points sequentially. And as I indicated, we should be about flat year on year. The underlying performance of EMEA/LA is very strong, as I indicated, and the backlog margin is now being realized at an elevated rate.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And are you still for the third quarter kind of reaffirming what you had said last quarter? I assume with the guidance being as strong as it is for the third quarter on margins that you're still comfortable with the profile of the strong year-over-year at North America Field?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Correct. The numbers we discussed, Steve, are still intact for Q3 across the patch, including for North America.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay, great. Thanks a lot.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Thank you, Steve.

Operator: And our next question today comes from Noah Kaye with Oppenheimer. Please go ahead.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Good morning. Thanks for taking the questions. So you've got the acceleration in orders sequentially this quarter on a tougher comp. Maybe comment on orders expectations for the back half and pockets of strength that you see?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. When we look at what's happening commercially, you got to look at right from the pipeline we're developing to how they're converting and what our backlogs are and how they're going to turn.

I'll start with the backlog. The backlog is up 9% in the field year-on-year. When you look at what's within that backlog, it's very resilient in line with our core strengths.

When we look at North America applied chillers, our backlog is up over 30%. And our revenue turn was roughly about 40%. When you look at all in relative to our revenue and that's continuing. We're seeing capitalization of the trends that are underway. We have a very competitive product lineup, and we're actually gaining share.

When you look at light commercial globally, where backlog is up 30% and revenues are turning about 30%. So extremely strong performance within the commercial sector.

When you look at North America commercial, which rooftops in addition to the applied, we're on a run rate now with backlog significantly up, and we're turning now better than 60% growth. And so our focus has been, how do we continue to strengthen the pipeline, the conversion.

And then with the capacity expansion we've had and the resolution of some of these constraints from a supply chain standpoint, has really helped us not only reduce lead times, so we can ultimately continue the growth, but now being able to execute on the revenue growth.

And so as we look at the secular trends in the pipeline development around sustainability, healthy buildings, digital now with the digital deployments that we have, we see still a very strong pipeline.

And so our focus is, how do we make sure within that pipeline we differentiate with our products, we differentiate with our solutions, leveraging digital. And that is what ultimately gives us confidence that we can continue to convert in a very positive way here through the second half.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Okay. Thanks, George. And then maybe you can characterize the inventory build in terms of composition and how you see that working down. Certainly, it's normal to see some seasonal build in parts of the business, but that's a longer cycle, higher components portion of it. Would just be interested in your characterization? Thanks.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. Let me address that, and then Olivier can talk about the financial impact. As you look at what's happened over the last couple years, we had significant disruption. And as a result of that, we built up inventory. All of that peaked from a days standpoint in the first quarter.

We've had the entire team now, now that we've been really leaning out and getting our capacity in place and working with our key suppliers, we've got the supply chain working pretty well.

And so as a result of that, we're not only making sure that we're protecting the significant ramp of the second half on the commercial backlog that I discussed, but then making sure that we can rebalance all of our input to output relative to the material required.

And so we've got line of sight to a pretty significant step-down in Q3 and in Q4, which gets us back to where we need to be from an overall inventory perspective.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Not much more to add. If you look at the inventory turns in Q2, we improved sequentially by 6 days. We didn't want to reduce the inventory by much more than that due to the strong demand we'll have to satisfy in Q3.

For the full year, we expect inventory to be back at the level it was at the end of 2022. And as we had discussed before, we want to keep improving the inventory turns as we get into 2024.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

That's very clear. Thanks for the color.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Thank you.

Operator: Our next question comes from Scott Davis of Melius Research. Please go ahead.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Hi. Good morning, fellas.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Good morning, Scott.

Scott Reed Davis
Analyst, Melius Research LLC

Q

I appreciate it. George, the parts numbers that you gave, kind of echo, Sprague's comment on service and parts, pretty amazing. I understand digital is a big role here, but is there any way to think about kind of your capture rates and how they've improved over time with digital?

I'm trying to picture, for the most part, if something breaks, people want to replace like-for-like, but maybe around the world, it's not always that case. But how much has digital improved your take rates or capture rates on those spare parts, I guess is my question?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Okay. So I think you'd start with the installed base that we're serving, and we're up pretty significantly, another 150 basis points.

So with what's driving that, Scott, is the connectivity. So we go back, we make sure that it's connected. We have the utilization of the data. We then manage what we traditionally have managed. We get productivity from that. We improve our value delivery.

And then we have with the insights after three months, six months, nine months, we're comparing that performance to the fleet. And that gives us and we know what vintage the equipment is, and then historically, we know predictively where issues are going to ultimately arise.

And so what we do is we then go back and do upgrades with parts and continue, and this is to avoid any catastrophic failure or just to improve overall efficiency.

And so when you look at our connected chillers now, our connected equipment, we're reducing attrition. It's about half of what the traditional service customer attrition was.

And so you get higher penetration of the installed base, you've got more ability now to use data to create value propositions on energy, on efficiency, overall utilization.

And then when you look at some of these bigger secular trends around sustainability, healthy buildings, and then ultimately smart buildings, it becomes the platform that we can then utilize all of our OpenBlue applications to build on top of.

So it's a combination of all of that. And then if you look at historically what has happened when we do have a contract, we're seeing significant pickup. When we say L&M is because it's coming out of the utilization of data and then how we're presenting additional opportunities to the customer to then be able to capitalize on. Does that help, Scott?

Scott Reed Davis
Analyst, Melius Research LLC

Q

Yeah. No, it does. And I think maybe just as a natural follow-on, when you use the term vintage, I think is appropriate. I think there's always been a view that the big chillers just last forever. And in fact, they seem to last a very long time.

But given decarb or other drivers, are you seeing the actual kind of useful life or vintage come down because there's a greater interest in people pulling 35-year-old or 30-year-old units out of service because it just doesn't make any sense, where maybe in the past, it did make sense to keep them alive?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

So what I would say is we've actually seen both. We have assets that we can go in and on a run rate basis significantly reduce energy consumed to benefit the customer and ultimately address some of the sustainability challenges that they're facing.

Then in other cases, we can put a value proposition together to upgrade the equipment, to deploy digital and then to get a payback based on how that equipment is actually operating. So that's what we do through our sustainable infrastructure business, which today we have a significant pipeline that we're working to convert. It's about $7 billion.

And so, Scott, it really depends on what the current operations are, what the current age of the equipment is, how it's operating. And then what we do is then try to provide our value proposition that is the best in their case that ultimately achieves what they're trying to set out to do.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Very interesting. Thank you. Best of luck, guys. Appreciate it.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Thanks, Scott.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Thank you, Scott.

Operator: Thank you. And our next question today comes from Chris Snyder with UBS. Please go ahead.

Chris Snyder
Analyst, UBS Securities LLC

Q

Thank you. So volumes in the quarter really stood out, that was a nice improvement to up 3% versus, I believe, down 1% last quarter.

Does this pickup just reflect the catch-up in volumes pushed out of last quarter or more so supply chain improvement or company capacity additions? And with that, when we look at around 9% organic in the back half, how much volume is expected on that?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Well, let me start by saying, operationally, we have seen significant improvement across our portfolio. So when you look at our velocity in the field-based business, you're definitely seeing recovery in the backlog, because that had built.

As you recall last year, we had extended our project cycle times because of supply chain and other challenges, that now is getting back in line. So that's some of the reduction and then the – or the increased revenue.

And then in the products business, the same holds true. We have really done some significant work in how we've expanded our capacity to now capitalize on these trends to be able to be competitive with lower or shorter lead times in the market, to continue the growth in the backlog, which is what we've done.

And so it's a little bit of both where we're recovering the backlog and then because of our ability to be able to better serve customers, that is ultimately helping us to be able to drive growth.

Chris Snyder
Analyst, UBS Securities LLC

Q

Thank you. I appreciate that. And then also wanted to follow up on service orders, but specifically the relationship between service and equipment orders. Service obviously has some pretty good secular tailwinds with OpenBlue and the market share opportunity that brings.

But there also is a connection between service and equipment when we look at attachment rate? So I guess my question is, if we do hit a period of cyclical pressure and equipment orders are down on that, what is the ability or the opportunity to kind of grow service orders through the cycle? Thank you.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Let's start with the overall model. So it starts with the installed base, and even though we've made significant progress, we still are currently performing service on short of about 50% of the base that we put out into the field over the last couple of decades.

And so the opportunity for us is to continue to penetrate that installed base, doing upgrades, deploying digital, and then ultimately providing these outcomes that I think with the combined portfolio that we have, which is a leadership HVAC equipment portfolio and a leadership Building Solutions, the two combined to be extremely differentiating relative to the outputs that we can create.

And so we believe that the continued expansion of the attach rate to that installed base, the ability to be able to connect, use data, there's significant value that we generate to our customers. And in any downturn, the single biggest reduction is energy savings.

And so when we deploy a full solution, we can reduce energy 20%, 30%, 40%. And then couple that with the improved overall operation of the building beyond just the chiller, there's significant benefits to be able to be achieved for the customers.

So I believe that the differentiation with the value, the ability to be able to go get more of our installed base, to build on that, real differentiated solutions, utilizing the data and AI is going to continue to allow us to be able to expand services no matter what the cycle is that we ultimately experience.

Chris Snyder
Analyst, UBS Securities LLC

Q

Thank you. Appreciate that.

Operator: Thank you. And our next question today comes from Julian Mitchell of Barclays. Please go ahead.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. There's been a lot of questions on the Building Solutions side. So maybe looking at Global Products for a second, you've had very, very good operating leverage first half of this year and the last two years. You're running up against some tough comps in the back half. So just wondered how you're thinking about the degree of margin expansion year-on-year in Global Products?

And then looking out beyond the very short term, when we look at some of your peers, Honeywell's margins are quite a bit higher. Your HVAC peers are somewhat lower. So how should we think about kind of normal operating leverage or incremental margins in Global Products beyond 2023?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

So let me just give you the overall strategy, and Olivier can touch upon the financials. When you look at what we're doing in the Global Products business, it starts with making sure we have leadership product. And we've invested over the last five or six years and I think we're positioned pretty much across the portfolio to lead and differentiate. And the differentiation obviously drives value with how we serve our customers. So it starts there.

The second is making sure that we're operationally local for local and making sure we have a robust and resilient supply chain, and we've made a lot of progress there. So from a cost standpoint, we ultimately can maintain low cost in how we ultimately serve the key markets that we serve.

And then from an overall SG&A, what we've been focusing on is really getting leverage out of the SG&A structure, and there's still significant opportunity ahead of us to simplify that, Julian.

And so I think, as we look at our product business, where we've been and where we are, there's still significant room for improvement. Obviously, it's going to be driven by the continued leadership product, the digital content, the connectivity that's going to ultimately be valued, and then ultimately that translates into the solutions that we provide in the field.

And so we're in a position to continue. We're getting good, continued strong price/cost because of the product and because of the value proposition. That's going to continue, Julian.

Olivier, do you want to...

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Yes. Absolutely. If you look at the second half for GP, as you said, Julian, the strength in the year-on-year margin trend will start to normalize because of the tough comp. And what will take over in terms of margin profile for the second half is our solution business, where you see the trend which happened in Q2 is going to accelerate in the second half of the year. So that's your first question.

Regarding your second question, beyond 2023, we believe we can deliver 30% incremental. George mentioned a few of the points supporting this. We believe in the Global Products, we have strong product offering. Heat pump is going to be part of this. And then we also are very bullish about what our Building Solutions margin could be at the back of solution services enabled by digital. On top of that, we have strong operating leverage capability in the P&L. As we keep growing, we have invested over the last two years. We believe this investment will start to slow down, and we should be able also to increase leverage next year.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Thanks very much. And then just my second one, more on the portfolio. You've seen some moves at one of your peers recently. So I just wondered. Given it's been seven years or so since the large very major portfolio move at JCI, how are you thinking, George and Olivier, about – are there elements of pruning here? Do you start to maybe get back on to M&A now that you're quite far through the current three-year plan in terms of savings extracted from the base business? And then to put a finer point on it, what is the appeal to you of that European residential heat pumps market?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Let's reflect on where we've been. We did the merger with the divestiture of this heating business back in 2016 with the merger with Tyco and Johnson Controls. And then we said from the strategy that we laid out was to really step back and understand what the future of buildings would be and what was going to be required to ultimately win with the trends that were underway.

We said at the end of the day, the value proposition with a leading HVAC business combined with having a leading building management platform, that the two combined is ultimately what's going to be required to be able to deliver smart, sustainable, healthy, most productive, most efficient buildings. And that has been our strategy.

So as we've been looking at our portfolio, continuing to strengthen HVAC, not only with our organic investments, but also looking at potential bolt-ons or gaps that we might have, and heat pumps has been a huge focus of ours. When you look at our heat pump portfolio, about half of our HVAC portfolio is made up of heat pumps. We've had significant reinvestment into heat pumps, and that's going to be a continued focus of ours, as you stated, from an M&A standpoint.

And then on the digital side, what's happening, the combination of what we've done in our building management system platforms coming together, now with a leading data platform with OpenBlue, it really does position us to now differentiate the solutions that we can ultimately serve our customers with, Julian, with the combination.

And so with that, from a capital deployment, we've been certainly providing, returning a lot of capital back to our shareholders through dividends and share repurchases, and that's continuing to be strong. And we're going to continue to focus on from an inorganic standpoint, where we can leverage the strength of the strategy that we're executing organically and how do we complement that with M&A.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

No, nothing more to add. Tuck-in is going to be the name of the game, services, digital, IP, and products. And in terms of pruning, George answered that is going to be really at the margin, but nothing significant we want to do.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Great, thank you.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Take care.

Operator: Thank you. And our next question today comes from Joe O'Dea with Wells Fargo. Please go ahead.

Joseph O'Dea
Analyst, Wells Fargo

Q

Hi. Good morning. Thanks for taking my questions.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Good morning.

Joseph O'Dea
Analyst, Wells Fargo

Q

I wanted to start. I think, George, you said about 50:50 mix in office on the sort of new versus retrofit side. Just wanted to confirm that it would be something similar for non-res exposure.

And then could you talk about sort of retrofit and how much of that activity is dependent on third-party financing, or most of that just internally sourced from customers? As well as the push versus pull dynamic, how much of these sales do you think you're sort of generating on the sort of push side and going out there and selling the advantages versus customers coming to you and asking for this?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

When you look at our vertical markets we serve in line with commercial, we talked a little bit about commercial, but it's similar percentages, plus or minus relative to install to service. A big focus of our company now is not only to get the equipment installed, but then to be able to, from a solution set standpoint, leveraging our data, to really then capitalize on that installed base with the recurring revenue over the life cycle. So there's a big focus on continuing to expand our services across all of the key verticals that we support. But it is, historically, if you asked the question, it's similar type percentages, install to service. It varies a little bit by vertical.

As it relates to non-res in general, when we look at the overall non-res, the indices that we look at, what we are seeing the benefit of is the construction starts are up, and a lot of that was the projects that got put into the pipeline over the last couple years and that's benefiting us. The good news is that ABI has come back a bit and stabilized somewhat positive here in the month of March.

So we look at the indices, they're still very strong. Our pipeline around non-res across the board is very strong. And our task is that to then within that pipeline to really differentiate. And that's what's happening, especially as we focus on these secular trends, as we talked about today around sustainability, healthy buildings, and then ultimately delivering smart buildings.

So we don't see significant differentiation across the verticals. I would tell you that right now, healthcare is strong and data centers are strong, and there's a lot of verticals that play to our strengths that we're capitalizing on. But I would tell you right now, it's pretty much across the board.

Joseph O'Dea
Analyst, Wells Fargo

Q

Got it. And then, Olivier, just thinking about the back half of the year, it seems like from a top line growth perspective, looks like the third quarter would be in a pretty tight band across the segments, something like high-single digit, low-double digit growth, and then Q4 maybe more mid-single digit, high-single digit across the segments.

The question is, when you look at it, where do you see the greatest upside risk? Is this primarily a function of ongoing supply chain constraints? And if those were to ease, where could you see things come in a little bit better?

Olivier Leonetti A
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

So if you look at today and you sense it from the call and from also our print in Q2, of course, you have always some risk in a large business like ours, but we're very confident about the market we are facing. The value proposition of our company is resonating.

If you look at the macro indicator level, the commercial markets across the world are actually strengthening. You see the backlog is strong. The backlog is growing.

So today, we think that this is a balanced set of expectations for the second half. And again, we said that all along, we have accumulated a sizable backlog that has very rich margin, and that is going to give us also a lot of momentum going forward.

George R. Oliver A
Chairman & Chief Executive Officer, Johnson Controls International Plc

I think a key statistic is when we look at our Global Products business, which kind of spans all of our markets, when you – with the exception of the softness we see in resi ducted, our backlog in our Global Products business, when you look at both direct and indirect, is up over 20%. And so you realize that, that ultimately plays to our strength with the work we're doing around the commercial sectors.

Joseph O'Dea Q
Analyst, Wells Fargo

Thank you.

George R. Oliver A
Chairman & Chief Executive Officer, Johnson Controls International Plc

Thank you.

Operator: Thank you. And our next question today comes from Nicole DeBlase with Deutsche Bank. Please go ahead.

Nicole DeBlase Q
Analyst, Deutsche Bank Securities, Inc.

Yeah. Thanks. Good morning, guys.

George R. Oliver A
Chairman & Chief Executive Officer, Johnson Controls International Plc

Good morning.

Olivier Leonetti A
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

Hi, Nicole.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Q

Maybe just starting on the orders, really strong in the quarter, accelerated versus 1Q. Any thoughts on how orders are trending into April? Has that strength continued? And also, any thoughts on how you guys are seeing orders in the third quarter just because the comp, the two-year stacked comp does get a little bit tougher from here? Thank you.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

I think when we look at our commercial operating system that we're really driving and really understanding market and the pipeline development, how we're converting by vertical, by region, looking at not only Global Products, but also Solutions, we're tracking as we have been.

Now, you understand through the quarter, typically, a lot of the project business gets weighted to the second half. So based on what we're seeing with activity with the pipeline that we're building and how we're converting, it's in line with what you would expect, Nicole.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Got it. Thank you. And then I know it's a small part of your business, but just wanted to discuss the North America resi market. I was just a little bit surprised to see it down high-teens for you guys, just a little bit worse than peers.

Can you just talk a little bit more about what you're seeing with respect to price versus volumes and the inventory dynamics in the channel? Thank you.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So when we look at resi, we look at it globally. Total resi was down about 4%. Obviously with JCH being up single digits with our North America business down in the teens.

Now, when we look at that, obviously, we're going through – we are seeing sequential improvement, not only through our operations, but now with the rebalance of inventory with our distributors, and that's playing out as we planned.

And then when we look at where the growth is going to come from, while the ducted business is under maybe a little bit of pressure in North America, our ability to be able to now capitalize on VRF and our RAC and PAC and our unducted or ductless business is very strong. And so when you look at our business there globally, it's starting to accelerate based on what we see.

And so I think that's a position that we believe we're going to be able to capitalize on, given the strength of our unducted portfolio and continue to be able to gain share there with the deployment of that product.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. I'll pass it on.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Thank you, Nicole.

Operator: Thank you. And our next question today comes from Joe Ritchie at Goldman Sachs. Please go ahead. Hello, Joe. Your line is open. Or is it perhaps muted? I apologize.

We'll go on to the next question. And that comes from Deane Dray at RBC Capital Markets. Please go ahead.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Good morning, everyone.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Good morning.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Hey, Deane.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

There was a reference early in the prepared remarks about pent-up stimulus still waiting to be released. Could you just take us through the key buckets there, the line of sight? And then where and how would you benefit?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. When we look at all of the programs that have been playing through with the COVID programs, the Infrastructure Act, the Inflation Reduction Act, and then in Europe, the Fit for 55, the Building Standards, we're tracking that pretty much across the board. And we participated in ultimately developing those bills.

And so as we're tracking this, if you look at the problems now our customers are trying to solve, whether it be education or healthcare or any of these type of problems, we started to see a pickup last year, and that's continuing this year and being able to now add funding, getting to our customers and ultimately converting, that's going to take – when we look at the deployment of all of that, Deane, over the next 10 years, it peaks roughly about five years out.

So it's not going to come into play immediately, but we are beginning to see those monies flow to the customers that ultimately can put it to work in solving some of these problems that they're solving around sustainability and healthy buildings and the like.

So we do see that as a – we sized the market on a run rate basis about $250 billion, when we did our Investor Day. We believe that the funding that's coming into play more than supports the ability to be able to capitalize on that market opportunity. And then with our not only leadership product, but the solution set that we're building with digital, that positions us to really get more than our fair share.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Got it. I appreciate that. And then a follow-up question for Olivier on free cash flow. Just given the comments and expectations on the inventory step-down in the second half, the cash conversion from that, is that included in your reaffirmed cash flow conversion guidance 80% to 90%, or would that be potential upside? Thanks.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

It is. It is included in our guide. And again, we discussed about this. We have clear line of sight of what needs to be done. We have reduced inventory sequentially by about 6 days, and we could have done more and indicated why we did not. We need to satisfy the strong demand we have in Q3. But we have clear line of sight of this inventory reduction and that's indeed embedded in our guide.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Thank you.

Operator: Thank you. And our next question today comes from Gautam Khanna with TD Cowen. Please go ahead.

Gautam Khanna
Analyst, Cowen & Co. LLC

Q

Hey. Good morning, guys.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Morning.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Good morning.

Gautam Khanna
Analyst, Cowen & Co. LLC

Q

I had a question that I was hoping you could help us with, which is on orders related to install. So I wanted to get a sense for how much is equipment price up year-over-year in the orders?

And then how much does equipment price represent as a percentage of a total job you'll book? Because I'm trying to understand, are you booking an install higher volumes as well as higher prices? If you could give us some color on that.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So when we look at our install business, it's really focused on the core as we've continued to make sure that we're increasing our installed base. And then ultimately, we're capitalizing on the recurring revenue we get through service over the life cycle. So on that business, we're increasing both price as well as volume on the core.

Where we defocused is some of the other contracting that goes in line with some of those projects that we've de-emphasized. But when you look at the core business, that ultimately is driving our product sales, and creating an installed base to be able to generate services, that's continuing to grow both price as well as volume.

Gautam Khanna
Analyst, Cowen & Co. LLC

Q

Okay. And can you say how much price is up on equipment maybe year-over-year within the install business?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

It would be – Gautam, it would be in line with the overall price that we're yielding as a company, we're high-single digits price.

Gautam Khanna
Analyst, Cowen & Co. LLC

Q

Okay. And then could you maybe refresh us on your targeted – maybe over the next 12 months where you think service attach rates, how much that could grow? Previously, you guys talked about 40%, where are you targeting over the next 12 months?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Well, what we're targeting is continued acceleration. Like I said earlier, we're up about 100% year-on-year with our connected chillers. That ultimately gives us the opportunity to get additional revenues and reduce attrition and improve the overall performance. And so what we committed is we're going to see just continued sequential as well as year-on-year progress in our ability to be able to now connect and mine that installed base.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

We think that this low-double digit growth in services is potentially subject to an acceleration. As we keep digitizing services offering, this service business will increase. Attach rate is one dimension, it's not the only one.

Operator: Thank you. And our next question today comes from Brett Linzey with Mizuho Americas. Please go ahead.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Hey. Good morning, all. Just wanted to come back to slide 5 and specifically the decarb and the healthy pipeline, about $10 billion. Can you just remind us what the hit rate or the conversion rate typically looks like there? And then is there anything unique or elongated about some of the timing on those projects?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So let's start with the sustainable infrastructure. We did have a nice pickup in orders, which was 29%, which was a pickup from Q1.

The revenue turned strong at roughly about 16%, and that's going to continue. The pipeline is about $7 billion that we've been working to convert, and this is where we put together a solution with our products, with our digital and then ultimately created an outcome, continued strong pipeline, execution, conversion on that.

On the healthy buildings, on a year-on-year, we're only up 2% orders but recognizing that was to a tough compare. We do believe our pipeline right now is up about 69% as it relates to these projects, so there's still significant demand. So that hasn't changed since COVID.

And we're positioned now with the differentiation not only with the product, but also now the digital solutions that really differentiate how we can actually serve the customer with those capabilities. So both are continuing to be very strong.

In addition, a lot of that also converts to service. When we go and sell our healthy Building Solutions, there's a tail that comes through with the services that we built.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

All right. Great.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

So I think that was the last question. Just I'd like to thank everyone once again for joining our call this morning.

We delivered a very strong first half and well positioned to build on that momentum in the second half of the year. Certainly, the digitization of our offerings continues to accelerate as we lead the way towards a smart, healthier, and more sustainable future for our stakeholders.

I look forward to engaging with many of you over the coming weeks.

And with that, operator, that concludes our call.

Operator: Thank you, sir. This concludes today's conference call. We thank you, all, for attending today's presentation. You may now disconnect your lines and have a wonderful day.