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Johnson Controls International Plc (JCI)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Johnson Controls Fourth Quarter 2021 Earnings Call. Your lines have been placed on listen-only until the question-and-answer session. [Operator Instructions] This conference is being recorded. If you have any objections, please disconnect at this time.

I will now turn the call over to Antonella Franzen, Vice President and Chief Investor Relations and Communications Officer.

Antonella Franzen

Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc

Good morning and thank you for joining our conference call to discuss Johnson Controls' fourth quarter fiscal 2021 results. The press release with 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 our Chief Financial Officer, Olivier Leonetti.

Before we begin, I'd like to remind you that during the course of today's call, we will be providing certain forward-looking information. We ask that you review today's press release and read through the forward-looking cautionary informational statements that we've included there. In addition, we will use certain non-GAAP measures in our discussions and we ask that you read through the sections of our press release that address the use of these items.

In discussing our results during the call, references to adjusted earnings per share, EBITA and EBIT exclude restructuring and integration costs as well as other special items. These metrics, together with organic sales and free cash flow, are non-GAAP measures and are reconciled in the schedules attached to our press release and in the appendix to the presentation posted on our website. Additionally, all comparisons to the prior year are on a continuing ops basis.

Now let me turn the call over to George.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Thanks, Antonella, and good morning, everyone. Thank you for joining us on the call today. I'm going to start off with a quick look back at 2021 and update you on a few of our long-term strategic priorities. Olivier will provide a detailed review of our fourth quarter results and provide you with our fiscal 2022 guidance. And as always, we will leave as much time as possible to take your questions.

Let's get started on slide 3. We rounded out fiscal 2021 with another quarter of solid financial results, having met or exceeded all of our original commitments for the year in what turned out to be a much more difficult environment than originally planned.

The ability to deliver these results while navigating through unprecedented levels of inflation and supply chain disruptions is a testament to the operational discipline and agility demonstrated throughout the organization. And for that, I am incredibly grateful for the efforts of the entire Johnson Controls team.

Despite the challenging external environment, our end market demand remains strong. Robust retrofit activity, coupled with a pickup in new non-residential construction we are starting to see, creates a strong future demand trend. This is evidenced by the continued momentum we are seeing in our order books and the record backlog we have built.

We also remain focused on the big picture, moving ahead with bold new commitments, doubling down with ambitious new ESG goals set earlier this year, embarking on a substantial new productivity program designed to drive a step function change in profitability. And just recently, at our Investor Day in September, we committed to a new set of three-year financial commitments.

We made significant progress in advancing our growth strategy, scaling our OpenBlue digital platform, launching eight new major offerings and greatly expanding our partner ecosystem, investing in the refresh of our product portfolio, focusing on accelerating our service growth and improving our attachment rate, and we are capitalizing on strong secular trends for healthy buildings, decarbonization and smart connected equipment in buildings. As end markets continue to recover and the adoption of these trends continue to expand globally, I am confident we are uniquely positioned from a competitive standpoint to continue to outperform.

Please turn to slide 4. In addition to the strong financial results and advancement on our strategic initiatives, we have also continued to lead in ESG, including continued progress toward both our 2025 sustainability goals and our new ESG commitments. This is not, by any means, an exhaustive list, but I am extremely pleased with what our teams have accomplished in the last year.

We are committed to net zero, committed to reducing emissions within our own operations and that of our customers. Our science-based targets have been approved. Our leadership team is aligned from a governance perspective, and we are extending our leadership in sustainable financing as well.

Tomorrow, I travel to COP26 in Glasgow. We made great progress in driving home the understanding that buildings represent approximately 40% of global greenhouse gas emissions, and there is no tackling climate change without substantial investment in buildings. Governments are now acting on this and mobilizing billions to upgrade buildings, and Johnson Controls is perfectly positioned to deliver those solutions. At COP26, I will meet with government and business leaders to build momentum and ensure action.

Turning to slide 5. I wanted to take a few minutes to highlight several new strategic developments in the quarter. Most recently, we signed an MOU with two significant technology leaders, Accenture and Alibaba, to address sustainable infrastructure needs. This collaboration will focus on an estimated multibillion-dollar market for digital solutions serving data centers in China.

We also signed a foundational technology agreement with Tempered Networks, building upon our recent cybersecurity partnerships with Pelion and DigiCert. Each of these partnerships embeds a critical layer of trust, security and operational capability into our OpenBlue Platform and connected devices. These elements differentiate our products and services to help protect the integrity of our customers' operations and data.

Tempered brings an industry-leading zero-trust secured network capability that helps us drive customer confidence and, in turn, accelerate the adoption of OpenBlue services. Our partnerships with UL, SafeTraces and with Phylagen are powerful examples of how we are innovating to extend our healthy buildings leadership, providing new indoor environmental quality solutions to address our customers' most pressing challenges.

Our near-term focus is on the education vertical, as there is a clear and compelling need to help those customers optimize their investments. With an estimated $195 billion in government stimulus earmarked for K-12 spending, this provides a significant opportunity.

Additionally, we entered into an exclusive joint development agreement and investment with Phylagen, a leading biotech company working on the identification of indoor bacteria and viruses that are all around us in buildings. Our work with Phylagen is a commitment to developing the cutting edge of capabilities to deliver and maintain healthy buildings.

Please turn to slide 6. At our Investor Day, we shared with you our three pillars for delivering above-market growth over the next three years and beyond. One of those pillars related to gaining share through innovative product development centered around digital and sustainability. As planned, we launched over 150 new products in fiscal 2021, spanning nearly all business units, resulting in continued share gains in both Q4 and the full year.

In 2022, we are well positioned to gain share with another 175 new products across four main categories: sustainability, smart buildings, digital and residential, with heat pumps central to our product development strategy. These are just a sample of what is expected to launch over the next 90 days with a steady pipeline behind this.

Turning to slide 7. Service plays a central role in everything we do. Over the last 18 months, we have strengthened our market-leading capabilities to best position ourselves for the shifting industry demographics and evolving digital technologies that are enabling outcome-based solution models.

At the start of last year, we began articulating our intentions to accelerate service growth to a couple of points above market levels, part of which would be the result of increasing our attachment rate by leveraging our large installed base and the digital transformation of our business.

In fiscal 2021, we saw the early benefits of our efforts shine through. We exited the year with service revenues up 8% in the fourth quarter with high single-digit growth in all three regions in nearly all business domains. For the full year, service revenue grew 4%, which is up 2 to 3 points over 2019 levels despite a slow start to the year, as we managed through lingering site access restrictions and abnormal customer budget pressures.

Looking ahead, we see service accelerating through fiscal 2022, in line with our goal to outpace the market. The order strength we've seen in the second half of the year bolsters that view. Service orders were up 7% in Q4 and, importantly, up low single digits organically versus 2019 levels. Additionally, we improved our attach rate to approximately 40%.

Turning to slide 8. The third pillar is our vectors of growth, which we believe on a combined basis represents an incremental market opportunity of $250 billion over the next decade. Our unique portfolio is a competitive advantage across all three areas. And from a financial performance perspective, we have significantly increased both revenue and orders in fiscal 2021. This positions us very well for continued strong performance as we move forward.

Next, on slide 9, I wanted to highlight a key customer win related to one of our key vectors of growth. In Q4, we were awarded a Buildings-as-a-Service project by one of our longstanding customers, the University of North

Dakota. This is the second long-term performance infrastructure contract we have been awarded with this university in the last two years. It leverages not only our expertise in performance contracting, but also the OpenBlue Enterprise Manager software.

The total contract value is nearly $220 million over the life of the project, with a smaller portion of that booked during the quarter. On a related note, our OpenBlue Healthy Buildings platform enabled nearly 900 colleges and universities to safely and efficiently welcome students, staff and faculty back to their campuses this fall.

Before I turn things over to Olivier, let me conclude with a few thoughts. I remain extremely encouraged by the demand patterns we are seeing across most of our end markets and the ability of our teams to capitalize on more than our fair share of that demand. We see this decade as being one of the most exciting for the smart building industry, which Johnson Controls is positioned to lead.

Underlying momentum in our short-cycle businesses continues to improve, despite pressure from ongoing supply chain and component availability constraints. Our longer cycle install business, driven by the new buildings market, also continues to recover, although extended lead times and inflation are delaying some investment decisions, particularly on larger projects. Retrofit activity remains an important driver of our business and we see plenty of opportunity to capitalize on this activity going forward.

All of that said, we are very mindful of the macro backdrop and our outlook does not assume any significant near-term improvement in supply chain conditions or inflation over the next couple of quarters. On price/cost, given the progressive rise in inflation, for almost all input costs throughout the year, we took decisive steps on pricing and cost to stay ahead of the curve, and I am confident we will continue to manage through these challenges.

Looking ahead to fiscal 2022, our focus turns to accelerating and demonstrating our growth capabilities. Our proven product technology leadership, combined now with OpenBlue, truly differentiates the solutions we can bring to our customers. In fact, we believe we are best positioned to lead the revolution of smart buildings, and we are fully committed to creating healthier, safer and more sustainable buildings.

With that, let me turn it over to Olivier to go through the details of the quarter.

Olivier Leonetti

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

Thanks, George, and good morning, everyone. Let me start with a brief financial summary on slide 10. Sales in the quarter were up 5% organically, led by Global Products, which is truly a reflection of the team's strong execution. Underlying momentum in this business continued to improve as evidenced by mid-single-digits growth on a two-year stack basis.

Our longer-cycle field business continued to recover, led by strong growth in services, up 8% in the quarter. Segment EBITA increased 10% versus the prior year, margin expanding 30 basis points to 15.9%. Better leverage on higher volumes, favorable mix and the incremental benefit of our SG&A actions more than offset the headwind from the reversal of temporary cost reductions and price/cost, including significant supply chain disruptions.

EPS of $0.88 was at the high end of our guidance range and increased 16% year-over-year, benefiting from higher profitability as well as lower share count. Free cash flow in the quarter was approximately $200 million, reflecting the reversal of timing benefits experienced in the first three quarters of the year as expected. On a full year basis, we achieved 105% free cash flow conversion.

Please turn to slide 11. Orders for our field businesses increased 9%, led by low double-digit growth in install on strong double-digit growth in retrofit activity. We are also seeing continued strength in our service business with orders up 7%, driven by strong growth in North America and EMEA/LA. Backlog grew 10% to more than $10 billion, with service backlog up 5% and install backlog up 11%. The sequential improvement was led by strong retrofit activity as new construction continues to recover from depressed level in fiscal 2020, particularly in North America.

Turning to our EPS bridge on slide 12. Let me touch on a few key items. Overall, operations contributed $0.09 versus the prior year, including a $0.04 benefit from our SG&A productivity program, achieving our targeted savings in fiscal 2021. We are well on track to achieve our SG&A and COGS savings in fiscal 2022 and beyond.

Similar to last quarter, excluding the headwind from the prior-year temporary actions, underlying incrementals in Q4 were approximately 30%. Corporate was a $0.03 headwind year-over-year and other items netted to a $0.06 tailwind, primarily related to lower share count, lower net financing charges and FX.

Let's discuss our segment results in more details on slide 13. My commentary will also refer to the segment end market performance included on slide 14. North America revenue grew 4% organically, led by strength in services, which was higher in all domain. Install revenue was up low-single-digits, primarily due to strong demand from shorter cycle retrofit and upgrade projects and positive growth in new construction. Both our internal and customer supply chain restrictions negatively impacted our North America install business.

By domain, commercial applied HVAC revenue grew mid-single-digits, while fire & security increased low-single-digits in the quarter. We had another strong quarter in performance infrastructure, which grew revenue low-double-digits, the fifth consecutive quarter of double-digit growth, a good reflection on our customers' demand for decarbonization solution.

Segment margin decreased 20 basis points year-over-year to 15.2%, primarily due to the reversal of temporary cost from the mitigation actions in the prior year. Orders in North America were up 11% versus the prior year, with high-single-digit growth in both commercial HVAC and fire & security.

Performance infrastructure orders were up nearly 40%. Applied HVAC orders increased 10% overall, driven by strong retrofit activity with another strong quarter of equipment orders, up over 20% in Q4. Backlog of $6.5 billion increased 10% year-over-year.

Revenue in EMEA/LA increased 3% organically, led by continued strength in our service business, particularly in our applied HVAC and industrial refrigeration businesses. Fire & security, which account for nearly 60% of segment revenues, grew at mid-single-digit rate in Q4 with strength across our enterprise accounts and residential security businesses, including a rebound in our retail platform.

Industrial refrigeration also grew mid-single-digits, while commercial HVAC & controls declined low single digits. By geography, revenue growth was broad-based, with strength in Europe and Latin America partially offset by low-double-digit decline in the Middle East.

Segment EBITA margins declined 30 basis point, driven by a prior-year gain on sales. Underlying margin performance improved as favorable mix, positive price/cost and the benefit of SG&A savings this year more than offset the temporary mitigation actions taken in the prior year.

Order in EMEA/LA continued to accelerate, increasing 7% in the quarter with strong mid-teens growth in commercial HVAC and high-single-digit growth in fire & security. APAC revenue increased 7% organically, led by low-double-digit growth in commercial HVAC & controls. EBITA margins expanded 80 basis points year-over-year to 15.5%, driven by a favorable reserve adjustment. APAC underlying margin decline year-over-year as volume leverage and net productivity was offset by unfavorable mix and negative price/cost. APAC orders grew 4%, driven by continued strength in commercial HVAC.

Global Products revenue grew 7% on an organic basis in the quarter with broad-based strength across the portfolio. Our global residential HVAC business was up 5% in the quarter. North America resi HVAC grew 4% in the quarter, benefiting from both higher volume and pricing.

Outside of North America, our residential HVAC business grew mid-single-digits, led by strong double-digit growth in Europe and driven in part by the launch of our new Hitachi air to water residential heat pump, which was well received by the market. In APAC, residential HVAC decline low-single-digits as a result of softer industry demand in Japan, given the COVID-related state of emergency in place for much of the quarter.

We continue to gain shares in Japan, up more than 100 basis points in the quarter as we continue to launch new premium products with indoor air quality technologies. Although not reflected in our revenue growth, our Hisense JV revenue grow over 40% year-over-year in Q4, expanding our leading position in China. Commercial HVAC product sales were up low-double-digits overall, led by mid-teens growth in our indirect applied business, including strong chiller demand within the data center end market.

Light commercial grew high-single-digits overall, with North America unitary equipment down 2% and VRF up high single digits. Our light commercial business in Asia was up low-double-digits, including a significant win in Taiwan to supply high-efficiency ductless unit with indoor air quality technology to all schools across the country.

Fire & security products grew high-single-digits in aggregate, led by our access and control and video solutions business and returned to pre-pandemic levels for parts of our fire suppression business. EBITA margin expanded 90 basis points year-over-year to 18.7% as volume leverage, higher equity income and the benefit of SG&A actions more than offset the temporary cost action in the prior year and price/cost, including the significant supply chain disruptions.

Turning to slide 15. Corporate expense increased significantly year-over-year off an abnormal low level to $83 million. For modeling purposes, we have included an outlook for some of our below-the-line items in financial year 2022.

I will point out that amortization expense reflects the full year run rate impact of Silent-Aire as well as additional software R&D. Net financing charges returned to a more normal level as fiscal 2021 benefited from significant FX gain. Non-controlling interest reflects continued growth in our Hitachi JV.

Turning to our balance sheet and cash flow on slide 16. Our balance sheet remains in great shape. We ended the year with $1.3 billion in available cash and net debt at 1.8 times, still below our targeted range of 2 times to 2.5 times. On cash, we generated a little over $200 million in free cash flow in the quarter, bringing us to nearly $2 billion year-to-date, and achieving our target of 105% conversion for the year.

As you will recall from our guidance last quarter, we expected a reversal in some of the timing benefits we experienced earlier in the year. I am extremely pleased with our cash performance and remain confident that we will sustain 100% conversion over the next several years. During the fourth quarter, we repurchased a little over 4 million shares for approximately $300 million, which for the full year brings us to around 23 million shares or $1.3 billion.

Let's turn to slide 17 for a look at our historical Q1 seasonality. As you can see, Q1 typically represents less than 15% of our full year EPS given our normal seasonality. For Q1 of fiscal 2022, we expect to be above that level with Q1 guidance representing about 16% of our full year at the midpoint. Additionally, we expect an improving first half/second half versus historical seasonality.

As we look at fiscal 2022 overall on slide 18, we are entering the year with record backlog and underlying markets are continuing to improve. With that said, we do expect supply chain constraints and the inflationary environment to continue, at least over the next couple of quarter.

On the full-year basis, we expect high-single-digit organic revenue growth with 70 to 80 basis points of segment EBITA margin expansion. Although we expect to remain price/cost positive on an EPS basis, the inflated level of pricing will result in margin headwinds of approximately 40 basis points for the year. Underlying margins are expanding to 110 to 120 basis points. Additionally, we expect another year of strong earnings growth with adjusted EPS in the range of $3.22 to $3.32, which represent year-over-year growth of 22% to 25%.

Turning to slide 19. We can see that our expectations for fiscal 2022 are very much in line with the growth expectations we provided at our recent Investor Day, and we are accelerating growth in each area. Last, on slide 20, I want to reiterate that we are well on our way to our 2024 targets.

With that, operator, we can open up the lines for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question will come from Nigel Coe of Wolfe Research. Your line is open.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning.

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

A

Good morning.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Good morning. So, yeah, it seems – thanks for the details on the business performance. It seems that you're outperforming in a few key areas. North America residential would be one. It seems like the applied performance was also better than some of the peers we've seen so far.

And performance contracting kind of stands out with five quarters now of double-digit growth. So I'm just wondering if you can maybe touch on those three areas in bit more depth. And the resi, I think you're still more skewed towards independent distribution. So I'd be curious if you could just maybe break out the sell-in and the sell-out performance there. Thanks.

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

A

Yeah, Nigel, just for clarification, what was the first comment you made?

Nigel Coe
Analyst, Wolfe Research LLC

Q

Really, it's about – I mean, if you could just maybe comment on North American residential performance versus the industry applied high-single-digit growth and then performance contracting. It feels like you're outperforming your competitors. I'm just wondering if you could maybe just comment on how you feel your market shares are performing. And then just on residential, if you could just comment on sell-in versus sell-out in that channel. Thanks.

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

A

Sure. So if you look at North America and let's focus on the commercial HVAC market. Certainly, this is a very attractive end market. It has long secular drivers that align very well with our core. And as you know, Nigel, we've been investing nicely, reinvesting into our product, and I think overall we're taking share for the year, we're going to be up about almost 200 basis points.

Big focus on energy efficiency and sustainability, and that's supported with not only our industry-leading chillers, but also now with the new rooftops that we're bringing into the market with low GWP refrigeration that's driving increased efficiency and driving service.

And then we're investing more heavily now in the next-gen air-cooled technologies, electrification with heat pumps and heat transfer units as well as advanced VRF technology. So as you said, we have had strong performance not only in North America, but across the globe, across the board. That's also enabling us to be able to create a very nice installed base and get that connected, which drives to longer-term services. And all of this is being enhanced with our digital capabilities with OpenBlue.

So specifically in applied, when you look at the demand for retrofit opportunities, driven by healthy buildings and return to work and school, particularly in North America, that was very strong with our Controls airside and filtration. A lot of that's been driven by K-12.

We also see a strong demand globally for air-cooled chillers in data centers and rental markets as well as industrial heat pumps in both chiller and [ph] our higher (00:31:09) portfolios. And so when you look at our orders globally in Applied, it's up 11% globally. North America, when you look at purely equipment, it's up kind of mid-20s, which was very strong and that's sequentially to a very strong quarter that we had in the third quarter. So overall, we're gaining nice share, as I said, for the year, up almost 200 basis points.

Now as it relates to – on the residential, when we talk about the residential space, we continue to perform very well. When you look at our residential business inducted, we have a nice backlog. We were up significantly in backlog, and we're continuing to perform well. We've been investing in new products here and ultimately gaining share, and we feel good about that.

Now, globally, when you look at the overall position that we have globally in residential, we had decent performance in our JCH business, which was up about 4%. And I think as we look at that business, we've been gaining share and continuing to perform with the new products that we've been able to bring to market.

We – although Japan was down 11%, we outperformed in that market. You know that that's a big end market for us. We had strong growth in Europe, which was up about 35%. And as Olivier said that the China, the Hisense business, the HAPQ is up over 40%. So, overall, we feel good about our overall performance in residential.

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

A

Let me comment also on performance infrastructure, Nigel. This is a proxy for what is happening in the market for sustainability. As we put in our opening remarks, orders for this business for the year was growing at 42%. And we are very pleased about how this business is behaving across the globe. We have created a practice now at Johnson Control fully dedicated to sustainability, and we are very excited by what we can do for our customers on this front, Nigel.

Nigel Coe
Analyst, Wolfe Research LLC

Q

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

Operator: Thank you. The next question will come from Gautam Khanna of Cowen. Your line is open.

Gautam Khanna
Analyst, Cowen and Company, LLC

Q

Yes, thanks. Good morning, guys.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc

A

Good morning, Gautam.

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

A

Morning.

Gautam Khanna
Analyst, Cowen and Company, LLC

Q

Would love to hear your thoughts on service attach rates sort of this year and what you think the ultimate entitlement is, 40% goes to 50%, does it go to 60%? And if you could just talk through the economics, how that bolsters the margins and the like. So, what – it looks like you're above your plan. So, I'm just wondering if we have a new target out there. Thanks.

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

A

Yes, let me start. Service has become core to everything we do. We've got an incredible base of service, over $6 billion. We've got about 55% of that recurring and we're making a lot of progress. Certainly not only expanding our market coverage, we've been enhancing our technology and now deploying a lot more digital content within the solutions that we provide to our customers.

And we've been going after the underserved installed base, with an incredible installed base, we have a material opportunity and we believe a competitive advantage now with the technology that we're bringing to really create a lot of value. And it's got a very attractive margin profile, as you know, 2 times the company EBITA margin.

And so, that all being said, with the investments we've been making, we've been certainly not only as we bring new projects to the field, we're getting a lot more connectivity and getting attached PSAs, but we've been going after the installed base, which historically we had not served.

And so this year, with the work that we did, we got that attach rate up to now 40%. We're continuing to make a lot of progress with that installed base. We're committing another 300-basis-point to 400-basis-point improvement in 2022. And that's all tied to when you look at the new services that we're bringing to the market, we're bringing 20 new service products and offerings in 2022 across our domains, leveraging technology and data insights.

And that will enable our customers to not only reach their clean air, fire & security as well as sustainability goals. And that's going to be a big focus for us. We believe, as we laid out the guidance that we are on track in being able to outperform the market and be able to outperform by roughly 200 basis points, 300 basis points on a go-forward basis.

Gautam Khanna
Analyst, Cowen and Company, LLC

Q

Do you have a sense for the upper limit though in terms of what that attach rate could get to, 40% goes to 50% goes to 60%, what do you think the upper limit is? Thank you.

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

A

Yeah, we believe when you look at our technology and our capabilities to truly now differentiate how all of the equipment that's been installed, really differentiating the performance, we have the opportunity to go after all of it. Now that all being said, there's customers that do some of their own self-maintain and the like, but we believe there's going to be an element of service that we can provide to that entire installed base.

So we're going to be driving to – we're attaching on new projects, we're getting a very high attachment and now going back after the installed base with these service offerings, which are huge value creators that we have an ability to be able to go after all of that, and we expect it to get to 70%, 80% here over the next few years.

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

A

The attach rate on new products is indeed very high and very much representative of the quote that George has mentioned, 70%, 80% attach.

Gautam Khanna
Analyst, Cowen and Company, LLC

Q

Thanks very much guys.

Operator: Thank you. The next question will come from Josh Pokrzywinski of Morgan Stanley. Your line is open.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Hey, good morning, guys.

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

A

Good morning.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Morning. So first question on supply chain. George, any revenue or orders for that matter that got pushed out as a function of what's going on in the market? And then on the kind of bottlenecks that you guys see, does field labor become an issue as we go through 2022?

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

A

Yeah, let me start with the first question there. When you look at what we've done here in the last year, given all of the volatility, I would say that our team is operating at top quartile, that we have been able to navigate and be able to stay ahead of the disruption. We've been working closely with our suppliers. We're working closely with our customers.

And ultimately, we've been able to deliver on our commitments. And so, we're going to stay proactive. We're going to continue to work it. With that all being said, we do believe that in the quarter, that there was probably an impact of about 1% to 2% on top line as a result of the shortages that hindered our ability to be able to convert all that we could have, but the team overall has done a great job working with our suppliers to be able to mitigate the impact and ultimately secure the critical materials.

Now as it relates to labor, because of our growth rates and the like, we have had a program management team globally to make sure that we're positioning ourselves to get all of the critical talent that's going to be required to support the growth strategies that we laid out during the Investor Day, which we feel very good about. And so, we have been able to stay ahead of the curve in being able to bring on, whether it be the skilled technicians, the technical capability that we need to support OpenBlue, all of the different capabilities to be able to produce.

Now, with some of the demand, we have been – we talked a little bit about the accelerated demand in unitary, residential and as well as rooftops. We've had – we've been stretched with capacity. That being said, we have been bringing on new capacity. We just brought on some additional capacity here in the last month, which will help improve our abilities there. But overall, I feel very good given the volatility and our ability to be able to attract and retain the talent we need and ultimately work with our suppliers and work with our customers and try to mitigate the impact that we're seeing both in orders as well as our ability to fulfill because of shortages.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Appreciate that, George. Just a quick follow-up for Olivier. Can you spike out what price and costs are individually in 2022?

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

So in 2022, the inflation we are planning to have is about 3% to 4%. So for 2021 was about 2%, the exit rate in 2021 was a bit higher, 2% to 3% for the full year of 2022, 3% to 4%. To answer to your question on price/cost equation, we have now – we have a great pricing practice at Johnson Control. I can't go into the details, if you have another question on this, but we have been in Q4 price/cost positive, including excess logistic cost in the equation. We have been price/cost positive in the second half, and we are planning to be price/cost positive in 2022 as well, including in Q1, Josh.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC
Q

Perfect. Appreciate the color. Good luck, guys.

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

Welcome.

Operator: Thank you. The next question comes from Scott Davis of Melius Research. Your line is open.

Scott Reed Davis
Analyst, Melius Research LLC
Q

Thank you, operator. Good morning, everybody.

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

Good morning, Scott.

Scott Reed Davis
Analyst, Melius Research LLC
Q

George, do you mind talking a little bit about this Accenture and Alibaba deal. What exactly are you doing for them? What's the scope? And can it widen out beyond China? Is this some sort of experimental test and if it goes well, you move on? Or I'll just leave it at that and let you address it.

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

Yeah, Scott. So we talked a lot about this at our Investor Day. When you look at what we're doing with OpenBlue and the technology and the domain and expertise that we bring to buildings and infrastructure, how do we build out our ecosystem. So that when you look at a holistic solution, we have the right technology partners and we have the right go-to-market partners.

And so as we've been doing that, we've been working closely with Accenture relative to their capabilities in how we go to market and ultimately driving a full holistic solution around sustainability, and then working locally with Alibaba and working with Daniel Zhang relative to getting the technology required to be fully successful within the China market and being able to serve those customers with our full holistic solutions.

So we believe the market opportunity, Scott, is multibillions with what we're going after. It ties to our – it really ties to our ability to drive decarbonization. And obviously, with that more healthy buildings and ultimately connected buildings that drive different outcomes within the infrastructure that we built. And so we're very excited with the partnership, and I think as we deploy our holistic solutions, critical partners in being able to execute.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Okay. Helpful. The labor availability issue, has that been much of an issue for you on the install side, George? Is that a risk in 2022 increasing or is it decreasing risk?

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

A

So like I said in one of the previous questions, I think we've done really well, Scott, and our ability, I think, with the continued performance of the company, with the exciting strategy that we have in going after these growth vectors and then our ability to be able to really attract the talent that we think is critical to being able – to be able to be successful.

And so we've had typical challenges here or there. But overall, I've been very impressed with the ability to be able to attract. And we also use in the install business, to your question on install, we do use contractors or subcontract labor, and we made sure that every step of the way as contingency, we've got the right labor in place, whether it be our direct labor or through our contracted labor. And so I would tell you that obviously, this was a let's say, a risk factor that we saw early, and we've been managing it really well and positioning to be able to continue to deliver on the commitments we've made.

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

A

An additional point, Scott, our productivity program now, which is ramping and which would impact COGS this year is also based upon increasing the productivity of our field operation, including the productivity of our engineers. So that program is coming also handy at this point in time and is helping us also to manage those labor availability challenges you have mentioned.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Okay. Thank you, guys. I appreciate it. Good luck. Thank you.

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

A

Thank you.

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

A

Thanks, Scott.

Operator: Thank you. The next question comes from Jeff Sprague of Vertical Research. Your line is open.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Thank you. Good morning, everyone. Two from me if I might.

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

A

Morning, Jeff.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Morning. Hey, first, just back to service. I just wonder if you could talk a little bit about the – I guess, the phrase I use is calorie count – not only is the attachment going up, right, but a clear focus here is to add additional services and the like. I just wondered to what degree that is showing up in what you're putting in your backlog and what that might portend as we look forward another year or two.

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

A

Yeah. So when you look at – like I said, this has become a central focus for the entire organization, recognizing that all of the investments we make in products, as well as now with OpenBlue, the translation of that, Jeff, is into a solution into a recurring revenue that ultimately creates more value for our customers. And certainly, we get the return to our service margin rates.

And so when you look, the traditional service business, obviously, that's come back nicely post-pandemic. Well, the accelerator now is what we're doing with digital, the new OpenBlue offerings. That all is helping us increase attach rates and then not only attach rates, but now additional services, taking the intelligence, applying AI, and ultimately now delivering these new service offerings.

As I said, through 2021, we delivered 15 new service offerings. A lot of those were tied to healthy buildings, sustainability, all of our key growth vectors and we've been able to build a tremendous pipeline of opportunity that we're now beginning to convert. When you look at service orders, we're up 7%, above the 2019 levels, and we see that continuing with that momentum because not only is it – we're getting the core businesses coming back and we're going to continue to maintain that with the traditional service business that we perform.

More important now is the conversion of all of the new services on top of that that has become the accelerator. And so we believe that we're positioned here well to continue to build backlog to get more of it recurring, and ultimately with the value that we create continued very strong margins on that service going forward.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

And then I'll take Olivier upon his offer to just elaborate a little bit more on price. It does look like on a price/cost basis, you are doing a bit better than some of your peers. I just wonder if you could unpack a little bit kind of equipment price versus service price, how you got ahead of the curve and is one side or other of that house, service versus equipment, really driving the equation. And I'll leave it there. Thank you.

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

A

Jeff, I'm going to answer to both, because really the model we have today covers both. So you mentioned that we have executed very well in term of price/cost. And price/cost is actually one of the, of course, foundation of our operating model.

Let me mention a few levers we are using today. One, we have priced projects through last year anticipating some level of inflations. That's point number one. Point number two, we had modified about two years ago our contract agreement to allow us to adjust pricing.

Point number three, we have identified now, because of our business intelligence, part of the market which are less sensitive to price. Point number four, and George mentioned that today, our offering now provide great value to our customers, decarb, sustainability, indoor air quality, and we offer great ROI for our customers and then price to value.

Our backlog is now also shorter, so we can adjust pricing faster. On materials, for a large part of our whole materials today, we have hedge program covering costs for about six months. And last but not least, across the enterprise at Johnson Control, our workforce is incentivized to drive pricing, pricing rate. So as a result of all of this, you end up with the results we have been posting, Jeff.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Excellent. Thank you.

Operator: The next question comes from Steve Tusa of JPMorgan. Your line is open.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Oh, hey. Good morning, everyone. This is Pat on for Steve. A quick question just on the organic growth path for the year. Starting off at mid-single-digits in the first quarter and then accelerating to 7% to 9% for the year. Can you talk about the levers there? Just trying to understand the visibility of that; is it supply chain relief, is it a ramp in pricing or something else? Just want some color on that, that would be helpful.

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

A

Right. So in the growth we have mentioned high-single-digit organic growth, pricing is about 3% to 4% in that number. If I decompose the growth by vectors, services is expected to grow 6% to 7%. We mentioned why that is at length through some of the questions we had earlier.

In term of install, install is a very strong business, particularly at the back of retrofit. This is a business we expect to see growing at about 6% to 8%. And Global Products, we expect this business to grow in the low teens. It's a strong vector of growth for Johnson Control.

Our team is doing great work launching new products. The new products we're going to launch next year is accelerating. We mentioned more than 175. We launched about 150 this year. And a large proportion of those products, a large proportion use heat pump as a key technology.

So we believe today we have many vectors to grow the enterprise, leveraging also the secular trends impacting this industry, decarbonization, indoor air quality, digitalization of the building space. And we are very excited about what we have in front of us and also what we're building at Johnson Control still.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Yeah, I think – I appreciate the color. I guess what I was really asking is, so first quarter, you're guiding up mid-single-digits, the year you're guiding up 7% to 9%. What drives the ramp from mid-single-digits in the first quarter specifically to kind of that high-single for the year? So you expect growth to ramp through the year?

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

A

Yes. We do. The vector of growth are going to deliver more, sustainability will drive more of the growth, service will drive more of the growth. So you see the acceleration of the various vectors being at play across the year.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Okay. And then...

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

A

And I would say there is still a little bit of pressure that we – similar to what we saw in fourth quarter relative to our ability to convert. But again, it's minimal.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Understood. And then my follow-up is on the – there's been a lot going on in the portfolio over the last couple of years, so hard to get a read on normal seasonality. But you mentioned it in the slide. So you said first quarter is typically 15%. What do you consider to be normal seasonality for second quarter, third quarter and fourth quarter? If we could get some color on that, that would be helpful in modeling. And I guess we should assume second quarter is above normal, just like first quarter is given your first half/second half comments?

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

A

So it's a very precise question. Typically, the first half at Johnson Control has represented about 30% of the total year, we believe we'll be in the mid-30s in the first half, considering by the way the supply chain constraints we are seeing today, it's factored in that statistic.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Very clear. Thanks so much for the details.

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

A

Welcome.

Operator: Thank you. The next question comes from Julian Mitchell of Barclays. Your line is open.

Julian Mitchell
Analyst, Barclays Investment Bank
Q

Hi, good morning.

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

Morning.

Julian Mitchell
Analyst, Barclays Investment Bank
Q

Just wanted to touch on – good morning – incremental margins and sort of operating leverage. So it looks like you're dialing in maybe a mid-20s rate for the year, closer to 20% incrementals for the first quarter. Is the key headwind sort of for the year just all about price/costs, anything else to call out? And maybe help us understand how you see that 40 bps price/cost margin headwind sort of phasing through the year?

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

So, you're right. The incremental in the P&L are in the range of mid-20s, so 25%; adjusted for price/cost, it would be in the 35% range. Meaning we are aligned to what we had communicated to you. Our productivity program is intact. We expect to save about – have a net saving of about $230 million this year, which will flow to the bottom line. In addition to that, we'll have a 30-basis-points improvement in margin.

If you look at the phasing, the 40 basis points impact in margin for the year is going to be a bit higher in Q1, slightly higher. And I want to precise again, this is important, price/cost positive in dollar [indiscernible] (00:54:52) in rate, including also extra freight cost, for example, Julian.

Julian Mitchell
Analyst, Barclays Investment Bank
Q

Thanks very much. And then just secondly, maybe switching to the revenue line, maybe just fill out in a bit more detail the assumptions for organic growth this year, what's underpinning the sort of fire & security assumptions versus a commercial HVAC in terms of applied and unitary, that would be helpful, just what you're dialing into that 7% to 9% for those main pieces.

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

So, the commercial HVAC will grow slightly faster than fire & security. Fire & security is going to grow well as well. That's why I anticipate – the reason for this is that, fire & security, this portfolio is totally part of our digital offering in the context of a smart building solution. So, those two businesses going to grow.

And you know that as well, Julian, fire & security has a very attractive margin profile. And more and more of those devices are actually sensors in the building, allowing us to develop digital trains and the like.

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

And Julian, I think it's important to note that on the short-cycle fire & security business, it's coming back very nicely. We saw our products business up 9%. We've got great backlogs there. So, that's continuing.

The field-based business has been a little bit slower on the recovery because they don't – we don't have the focus on clean air and all of the work we did with our HVAC and a lot of the focus on short-term on sustainability. But we see some nice trends here. So, through the course of the year, we'll continue to accelerate, but it will be short of where we – what we see commercial HVAC to be for the year.

Julian Mitchell
Analyst, Barclays Investment Bank
Q

Great. Thank you.

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

Welcome, Julian.

Operator: Thank you. The next question comes from Deane Dray of RBC Capital Markets. Your line is open.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Thank you. Good morning, everyone.

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

Morning Dean.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Hey, just like to follow up on Julian's first question and just make sure I understood Olivier's answer. So, on the – the question is the clarification on underlying margins, EBITA being 70% to 80% (sic) [70 to 80 basis points] up in fiscal 2022. The cost takeout program, that net of $230 million, that should contribute 90 basis points, if I've got the math right. So, does that imply the underlying margins are worse? Or is this just an element of conservativeness at the beginning of the year?

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

So, you're right. If you factor the impact of the COGS and productivity program is close to 1 point, you will have to factor also Silent-Aire in the equation, which is dilutive in rate. But we see today, net of the price/cost, I've mentioned the 40 basis points, if you do the math, you end up with a margin expansion higher than 100 basis points, 110 basis points to 120 basis points. And as I indicated, our margin profile is improving because of the value of our offering and our productivity program is well on track.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

All right. That's really helpful. I'm glad you pointed that out. And then second question, George, can you talk about the outcome or performance-based contract growth assumption for 2022? We've seen this ramp pretty impressively from – I think it was 2% in 2020, 15% at one point in 2021. What's the assumption for 2022?

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

A

Yes. So as we look at this business, we have a lot of conversion coming from what would have been a conventional business to now incorporating that business into solutions – differentiated solutions. And so as we looked at, for instance, the partnership we have with Apollo and this is a focus on decarbonization and sustainability, we've got a pipeline that we're working that that's over $1 billion in how we're going to convert.

And now some of this depends on the timing of conversion of orders, but we're making tremendous progress, right now working a number of these and working to convert a number of these. So it's hard to say exactly what's going to ultimately come through performance contracting and then what we would still gain if it were not to be the full solution, what we would gain in our traditional HVAC businesses.

But, Deane, this is going to be – when you look at our vectors of growth, decarbonization and sustainability, healthy buildings and then ultimately, smart buildings, a lot of our go-to-market would be – we actually deliver an outcome solution. A lot of that will be done long term with – under performance contracting.

So we've got a leadership position today with our performance contracting business that ultimately has been focused on energy savings. We've expanded that. And now with our go-to-market, we have, I believe, tremendous potential here over the next few years to make this much more significant within the portfolio. But I feel really good about it, and it's going to continue to grow.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Appreciate it, thank you.

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

A

The pipeline statistic, Deane, the pipeline statistic we mentioned, this part of the pipeline at Johnson Control is the one growing the fastest by a margin.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's helpful. Thank you.

Operator: Thank you. The next question is from Noah Kaye of Oppenheimer. Your line is open.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Good morning. Thanks for taking the questions. Just a capital allocation question. Obviously, you provided a lot of color on the framework at Investor Day. But for 2022, can you first comment on the M&A pipeline strength, whether you're seeing some HVAC consolidation opportunities or other growth opportunities that are interesting. And then excluding any potential M&As, is sort of the default assumption in guidance that substantially all free cash flow is returned to shareholders?

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

A

So we – if you look at the free cash flow, so we said that in our prepared remarks, we are very convinced that we are 100%-plus free cash flow conversion company. We had a great performance in 2021. Because of this strong free cash flow, we're going to do two things. One, grow dividend aligned with earnings; and two, deploy $1.4 billion of buyback in 2022, more or less equally distributed among the four quarters.

On top of that, we believe, as we have said during Investor Days, we will add 1 to 2 points of revenue growth through M&A while staying into our leverage guide of 2x to 2.5x. M&A being focused on services, digital, decarbonization mainly. And the pipeline is growing nicely. We have a new team today leading this particular path at Johnson Control, and we are very pleased with the progress we are making in growing the pipeline.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Perfect, Olivier. And then just as a follow-up on that, with the Silent-Aire acquisition, clearly you signaled you're able to do more deals of that size. Can you just comment on whether or not that pipeline is accelerating in terms of flow in inbound inquiries, should that 1 point to 2 points that you expect this year, you view that as sustainable over a multiyear period?

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

A

Yeah, so let me take that. Certainly, this was directly aligned – this acquisition with our overall on capital allocation, M&A strategies right down the middle, a nice bolt-on. And overall, we're extremely pleased with the progress we're making. This is just a phenomenal opportunity here going forward. The data center market is a $16 billion market.

We have 5% share, and we have the opportunity to now leverage our entire footprint now to take advantage in a much bigger way of the global market. And so we see that growth to be very strong going forward. We're continuing to build the pipeline. We're expanding the customer base that we're beginning engagements with and how we innovate and serve their data center needs going forward. And so on a go-forward basis, it's going to be one of the significant growth contributors to the company.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thanks very much.

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

A

Thank you.

Operator: At this time, I would like to turn the call back over to George Oliver for closing remarks.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Yeah. Let me wrap up the call here today. I want to thank everyone again for joining our call this morning. As we discussed here this morning, we had a very strong finish to the fiscal year. And certainly, the underlying momentum that we're seeing in our businesses is extremely encouraging.

As we enter fiscal 2022, I think it's important to note that the growth accelerators are ramping and are well on our way to achieving our fiscal year 2024 targets that we laid out back in September, and we all look forward to continuing our discussion speaking with many of you soon during the conferences. So on that, operator that concludes our call.

Operator: Thank you all for your participation on today's conference call. At this time, all parties may disconnect.