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Johnson Controls International Plc (JCI)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Johnson Controls Fourth Quarter 2022 Earnings Call. Your lines have been placed on listen-only until the question-and-answer session. [Operator Instructions] This conference is being recorded. [Operator Instructions]

I will now turn the call over to Michael Gates, Senior Director, Investor Relations. Thank you.

Michael Gates

Senior Director-Investor Relations, Johnson Controls International Plc

Good morning, and thank you for joining our conference call to discuss Johnson Controls fourth quarter fiscal 2022 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.

As a reminder before we begin, during the course of today's call, we'll 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 are made to adjusted earnings per share, EBITA and EBIT, excluding restructuring as well as other special items. These metrics, together with organic sales, free cash flow, and other measures specified in the slide presentation 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.

With that, I will turn the call over to George.

George R. Oliver

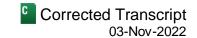
Chairman & Chief Executive Officer, Johnson Controls International Plc

Thanks, Mike, and good morning, everyone. Thank you for joining us on the call today. I will start out with a quick look back at fiscal year 2022 and update you on our progress across our strategic priorities. Olivier will provide a detailed review of our fourth quarter results and our fiscal 2023 guidance. As always, we will leave the remainder of the call to take your questions.

Let's begin with slide 3. As we rounded out fiscal year 2022, we delivered another quarter of solid results that had us meeting or exceeding our updated outlook for the full year. Despite a challenging macroeconomic environment that saw unprecedented inflation levels, foreign exchange headwinds and continued supply chain disruptions, we achieved robust top line growth and maintained margin strength as we closed out the fiscal year.

Compared to the prior year, reported sales for the year increased approximately 7% to \$25 billion and grew 9% organically, in line with the high end of our guide. The strong demand is also shown in total field orders, up

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approximately 10% organically year-over-year in our record backlog, which grew significantly, up 13% year-over-year. This strong demand backdrop further highlights our unique value proposition for mission-critical products and services supported by secular trends that continue to drive the industry.

We've made significant progress over the year, working closely with our suppliers to mitigate the impact of supply chain disruptions. We have also continued to execute our productivity savings plan, exceeding our \$230 million cost savings target throughout the fiscal year. Lastly, our disciplined approach to pricing has helped drive sequential margin improvement, offsetting material foreign exchange impacts as we continue to cycle through our higher-margin backlog during the second half of the fiscal year.

With our focus on fundamentals and execution, our team's work this year positions Johnson Controls to capitalize on our strong momentum heading into fiscal year 2023. Overall, 2022 was a significant year in improving our operations and increasing our competitive edge as we continue to deliver on enhancing our digital capabilities, leading the way for smart and connected building solutions.

Across the organization, we have continued to invest in key technologies and foster partnerships, allowing us to capitalize on the vectors of growth we serve. We've also continued to gain market share across our global products and services driven by Commercial HVAC, Industrial Refrigeration and Fire Detection.

We are in a great position to realize the benefits of our transformative service offerings through our differentiated digital platform. And as the trends for healthy and sustainable buildings continue to expand, I am confident in the strength of our capabilities, which continues to serve the needs of our customers.

Lastly, while the market is faced with macro uncertainties, we are seeing tailwinds within our business. Favorable government incentives across the world, global heat pump demand and continued backlog strength will provide us with additional momentum heading into fiscal year 2023.

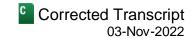
Now turning to slide 4. OpenBlue suite of connected solutions continues to play a vital role in meeting our customers' needs, laying the blueprint for the future of smart buildings. In fiscal year 2022, we have significantly expanded our suite of digital services and offerings, spanning across a breadth of devices from connected chillers, industrial refrigeration equipment to connected controls and BAS systems.

To-date, we have enhanced the existing connectivity of almost 11,000 chillers through OpenBlue, representing a 106% increase year-over-year. This provides customers with added levels of connectivity to monitor and improve performance with actionable insights.

We've also made significant progress in advancing the latest addition of our OpenBlue Bridge. With this solution, we can seamlessly reduce the complexity of integrating devices and expand the range of building solutions and devices that interface with the OpenBlue Stack. This provides our customers with the added benefits of AI at the Edge and gives them the peace of mind that comes with Zero Trust cybersecurity explicitly tailored for operational equipment.

Our enterprise software-as-a-solution offerings continue to expand, spanning from comprehensive enterprise management to specific customer use cases covering decarbonization, occupant health and safety. Along with these added capabilities, our footprint is also expanding. During the fourth quarter, we are proud to announce our recently launched OpenBlue Enterprise Management Solution for AliCloud, supporting our expansion of smart building solutions into China. The future lies with OpenBlue, and we are excited to continue disrupting the building environment as we look ahead to the upcoming year.

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Moving on to slide 5. While our digital growth strategies continue to mature, we have accelerated our core service growth through our Field business and the strength of our OpenBlue Service offerings. In fiscal year 2022, core service orders increased during the fourth quarter, with orders and revenues up over 7% and 8% year-over-year. By 2024, we anticipate additional service revenue opportunities of more than \$2 billion.

On to slide 6. Turning to our growth vectors, we are successfully growing our sustainability initiatives. Johnson Controls is uniquely positioned to take full advantage of recent favorable market tailwinds, including credits for renewable offerings from the Inflation Reduction Act, to an actionable shift towards heat pump usage as Europe continues to push for energy independence and low-emission alternatives.

Heat pump demand continues to be a momentum driver, and we have gained market share, realizing \$800 million in the quarter, representing 48% of total HVAC sales. Our partnership with Microsoft is driving results in their Beijing's West Campus, helping reduce emissions and improve uptime. In addition, our work with Colorado State University has helped transform the campus and reached net zero electricity throughout our 20-year relationship.

We help customers design, digitize and deploy solutions to achieve net zero. We are continuously expanding our OpenBlue Net Zero Buildings offerings. Decarbonization is a priority among our customers. And as climate change poses an impending risk, we continue to build out energy-efficient and secure solutions. During Q4, we had our largest historical quarter of about \$420 million in orders, which led to secured orders of over \$1 billion for the full year, growing 12% year-over-year.

Turning to slide 7. The healthy buildings market opportunity remains strong as our customers invest in unlocking employee health, wellness and productivity benefits associated with well-managed indoor environments. We are positioned to capture this trend and help customers manage challenges through our OpenBlue Indoor Air Quality as a Service with some exciting wins coming in Q4. Additionally, we're leading the way in advancing new solutions and research into the linkage between healthy buildings and decarbonization helping our customers achieve both outcomes simultaneously.

Notably, during the quarter, we delivered promising results. In fiscal year 2022, orders increased 45% year-over-year. Our healthy buildings pipeline represents over \$1.3 billion in revenue and we expect continued order growth as more customers leverage the value of improved indoor environmental quality.

Now we turn to slide 8. We consistently demonstrate our commitment to sustainability. During the quarter, Fortune's 2022 Change the World list recognized Johnson Controls for our service offerings of OpenBlue Solutions and OpenBlue Net Zero Buildings. I am also very proud that we have been named one of Forbes World's Best Employers in 2022.

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

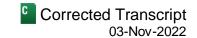
Olivier Leonetti

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

Thanks, George, and good morning, everyone. Let me start with the summary on slide 9. Sales in the quarter were up 10% organically, at the high end of our guidance of 9% to 10% growth, with price contributing nearly 9 points, in line with what we originally anticipated. We saw strong performance across our shorter cycle Global Products portfolio, up 11%. Our longer cycle Field businesses also performed well, up 10% with solid growth in both service and install.



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Segment EBITA increased 9% with margins expanding 55 basis points to 16.5%. Better leverage on higher volumes, favorable mix and the incremental benefits of our ongoing SG&A and COGS programs, more than offset continued supply chain constraints and dilutive but improving price/cost. EPS of \$0.99 was at the midpoint of our guidance and increased 13% year-over-year, benefiting from higher profitability as well as lower share count.

During the quarter, we absorbed an additional \$0.03 of FX headwinds versus the prior guide. Full year free cash flow conversion was 67%. As a result of the disruptions of the supply chain over the last two years, we have built up our inventory to meet customer demand.

Turning to our EPS bridge on slide 10. Overall, operations contributed \$0.16 versus the prior year, including a \$0.07 benefit from our COGS and SG&A productivity program, helping to exceed our targeted savings for the year. In the quarter, FX was a \$0.05 headwind. In addition, higher net financing charges and noncontrolling interest impacts were offset by a lower share count.

Please turn to slide 11. Orders for our Field businesses increased 9%, in aggregate. Install orders increased low-double digits in the quarter with continued demand for applied HVAC and Controls systems. We are also seeing continued strength in our service business with orders up 7%, driven by double-digit growth in both EMEALA and APAC. Field backlog remains at record levels, growing 13% to \$11.1 billion, a \$1.2 billion increase versus the prior year while remaining flat quarter-over-quarter. Lastly, our Global Products third-party backlog grew more than 25% to \$2.3 billion and continues to show strength.

Let's discuss our segment results in more details on slides 12 and 13. Sales in North America were up 9% organically with broad-based growth across the portfolio. Our install business grew low-double digits with increased retrofit and upgrade projects and new construction growth. Overall, HVAC and controls grew low-double digits and Fire & Security increased high-single digits.

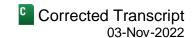
Orders were up 13%, with strong growth of more than 50% in our Sustainability Infrastructure business as our decarbonization solutions continue to resonate with our customers. Applied HVAC orders grew nearly 20% with another solid quarter for equipment orders, up over 30%. Fire & Security orders declined low-single digits. Total backlog ended the quarter at \$7.5 billion, up 18% year-over-year.

Segment margins in the quarter were 14.7%, a sequential improvement of 400 basis points, driven by increased volume leverage and the execution of projects with an improved booked margin profile. A direct results of the pricing discipline implemented earlier in the year. In the quarter, North America continued to be impacted by supply chain disruptions. Overall, supply chain was a \$50 million headwind, contributing to a 50 basis points decrease in the quarter year-over-year.

Sales in EMEALA were up 9% organically with continued strength in Fire & Security business, which grew at a low double-digit rate, in Q4, while Industrial Refrigeration, HVAC and Controls grew high-single digits and midsingle digits, respectively. By geography, revenue growth was broad-based, with strength in Europe, partially offset by low single-digit decline in both Latin America and the Middle East. Orders were up 3%, led by high single-digit growth in our Fire & Security platform. Backlog was up 7% to \$2 billion.

Segment EBITA margin declined 160 basis points to 9.4% as a result of unfavorable region and project mix, along with continued FX headwinds, which offset favorable volume leverage and the benefit of cost savings during the quarter. Sales in Asia Pacific increased 12%, driven by high-teens growth in our HVAC and controls platform. Service performed well in the quarter, growing low-double digits, in aggregate, benefiting from our shorter-term transactional business in China. Overall, China grew 16%.

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Orders increased 3%, driven by low double-digit growth in services. Install orders remained flat year-over-year. Backlog of \$1.6 billion declined 2% year-over-year. Segment EBITA margins declined 140 basis points to 14%, driven by FX headwinds, lower volumes and unfavorable mix due to high HVAC shipments, offsetting positive price/cost and the benefit of cost savings.

Sales in our shorter cycle Global Products business increased 11% in Q4, benefiting from strong price realization of 12%. Commercial HVAC product sales were up mid-teens, in aggregate, with strength in light commercial driven by 25% growth in North America and EMEALA, respectively. Applied HVAC sales were up 9% with continued chiller demand within our data center end markets.

Outside of North America, our global residential HVAC sales were up 8% in aggregate. North America resi HVAC was up mid-single digits, benefiting from both higher growth in our equipment and parts business and strong price realization. Our HVAC business grew low-double digits, led by strong double-digits growth in Europe, driven by continued demand for our Hitachi residential heat pumps.

APAC resi HVAC sales grew high-single digits, led by strong growth in Japan. Fire & Security products grew low-double digits, in aggregate, led by our access control and video solutions business and strong demand in North America and EMEALA for our Fire Detection products. EBITA margin expanded 300 basis points to 21.9%, driven by the benefit of our productivity actions, higher volume leverage and favorable mix.

Turning to our balance sheet and cash flow on slide 14. We ended Q4 with \$2 billion in available cash and net debt of – at 1.9 times, which is lower than our target range of 2 to 2.5 times. As previously mentioned, free cash flow was impacted by temporarily building up inventory to meet customer demand. In Q4, CapEx spend declined 29%. However, for the year, it increased 7% as we continued to make selective investments to improve efficiency and expand capabilities.

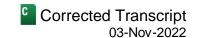
Before we get into next year's guidance, I wanted to provide some commentary on the special item recorded in the quarter. We recorded a \$255 million charge to increase our environmental remediation and related reserves primarily related to our facility in Marinette, Wisconsin, where contamination exists for the use of firefighting foam containing PFAS compounds.

Over the last three years, our team has made significant progress in our investigation and remediation activities, including completing construction of a groundwater extraction and treatment system. As a result of that work, we were able to perform refreshed analysis based on currently available information known to us to-date. This resulted in a reasonable estimate of the cost associated with the long-term remediation actions we expect to perform over an estimated period of up to 20 years.

Now let's discuss our fiscal year 2023 guidance on slide 15. Currently, we are seeing continued strength in demand adding into the first quarter of fiscal year 2023. Our backlog, which is at historical levels, continue to build along with our continued momentum across end markets. Orders remained strong, ending into Q1 with low double-digit organic growth expected as our value proposition continues to resonate with our customers. We anticipate low double-digit organic revenue growth with price contributing 10%.

Segment EBITA margin is expected to expand 120 to 130 basis points and adjusted EPS is expected in the range of \$0.65 to \$0.67, which represents year-over-year growth of 20% to 24%. On a full-year basis, we are taking a prudent approach and providing a wide range to reflect the macroeconomic uncertainty that could potentially

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impact the balance of the fiscal year. Our full-year adjusted EPS guidance range of \$3.20 to \$3.60 represents a 7% to 20% growth rate, respectively.

The top quartile of our range signifies our base case scenario. This accounts for normalized GDP growth, continued growth, vector acceleration and conversion of our existing backlog. The low end of this range \$3.20 provide a bookend reflecting a potential downside scenario. This scenario accounts for potential degradation of global GDP, which we believe will be offset by our resilient services and commercial market presence along with additional cost mitigation actions.

On the top line, we anticipate high single-digit to low double-digit organic growth with price representing about 10% as our offering continues to resonate with our customers. We anticipate segment EBITA margin expansion of 80 to 120 basis points as we continue to execute our higher booked margin backlog throughout the fiscal year. Full year cash flow is expected to be between 80% and 90%. Operationally, we continue to improve our working capital management and expect further improvements from the gradual reduction of inventories as supply chain normalizes.

As we close our fiscal year, we look forward to accelerating our strategic initiatives. We have aligned our business to minimize potential headwinds to enhance operational improvements, improve cost structure and productivity enhancements. We are optimistic given the strong fundamentals across our businesses. The resiliency of our products and services continue to resonate with our customers as our order velocity and backlog remains strong. Adding into fiscal year 2023, we look to continue our growth momentum and invest in advancing our digital service offering while capitalizing on secular trends.

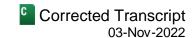
With that, operator, please open up the lines for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Andrew Obin, Bank of America. Your line is now open.

Andrew Obin Analyst, BofA Securities, Inc.	Q
Hi. Yes. Good morning.	
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
Good morning, Andrew.	
Andrew Obin Analyst, BofA Securities, Inc.	Q

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Yeah. So, just a question in terms of very nice pricing outlook into next year. I was just wondering if you could give us some color as to what the backlog looks in terms of pricing and what gives you confidence that this kind of pricing will be achievable next year?

Olivier Leonetti

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

So if you look at next year, indeed, we are modeling in our guide, 10% of price and about 1% of volume growth. In Q1, the volume would be much higher about 3%, with the price being about 10%. If you look at today, our order velocity today, which includes this kind of pricing is still growing. As we said in our prepared remarks, Q1 order is actually being very healthy and actually accelerating in Q1 relative to Q4. So we believe that the value proposition of our offering is resonating. The backlog is strong, and we believe we can command this kind of pricing, Andrew.

Andrew Obin

Analyst, BofA Securities, Inc.

Thank you. And the next question, we've actually got a couple of questions from investors just regarding your guide for next year. Top line, pretty good; margin, pretty good. I think the low end of the guide, just if you sort of try to look versus consensus. Just trying to see if there are any below-the-line items that are sort of impacting the EPS guide, as I said, because the top line and margin looks very much in line or better than the Street, but sort of the midpoint ends up being below. Thank you.

Olivier Leonetti

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

So what we indicated in our prepared remarks is that the wider range add two scenarios from a macro standpoint, a base scenario, which is what we believe is going to be the most likely case which will be the top quartile of the guide. That would equate to an EPS range of \$3.60 to \$3.50. Why do we believe it's the base scenario? A few reasons for that. One, at a macro level, the economy we are facing is still growing. Dodge, if you take the US, 51%. ABI is still strong. PMI at about 50. So no indication today that we have a slowdown. That's point number one. Point number two, our order velocity is still very strong. And we mentioned what those numbers were for Q1.

We have various incentive programs around the world, in the US, Europe. We have a strong backlog. We have a very resilient service business and a strong commercial exposure. So we believe that the base case is a top quartile guide. Now, we're also listening to what is happening out there and you have some economies, some CEO mentioning that we could have a slowdown next year. We believe that the worst case scenario from a slowdown standpoint will translate into a GDP based upon economist estimates of 0% to 1% in terms of growth. And we wanted to give you a bookend of how we will perform in the case we would have a major slowdown of GDP. But today, that's not what we are facing, Andrew, hence, the top quartile reference.

Andrew Obin

Analyst, BofA Securities, Inc.

That makes perfect sense. Thanks so much for the great explanation.

Olivier Leonetti

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

Thank you.

Operator: Our next question comes from Steve Tusa. Your line is now open.

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Analyst, JPMorgan Securities LLC

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Hi. Good morning, guys. How are you?

George R. Oliver

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Chairman & Chief Executive Officer, Johnson Controls International Plc

Good morning, Steve.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Can you just give a little more color on the guidance by the various segments? And then anything on the bridge that stands out? I guess, just from a residual cost savings or recovery of inefficiencies from this year? And anything that you guys can detail on the EPS bridge. Thanks.

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Olivier Leonetti

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

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Of course. So if you look at the elements of the guide, today, we see the business for services to be strong. We expect the service business to grow in the 11%, give or take, install business to be low double-digits and Global Products to be in the mid-teens. Price/cost would be positive. Of course, it was already, Steve, in the year. The price/cost equation is still going to be dilutive though next year, as we are not fully realizing covering the inflation we have been facing. That will be the main points regarding the guide, Steve.

Operator: Thank you. Our next question comes from Jeff Sprague with Vertical Research Partners. Your line is now open.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC

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Thanks. Good morning, everyone.

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Olivier Leonetti

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

Hi, Jeff.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC

Hey, just one more on the guide, and it doesn't look like you're including much, if any, capital deployment in the guide. What are your thoughts around that? And is there an active M&A pipeline?

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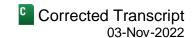
Olivier Leonetti

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

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So you're right, we are going to have a modest increase in CapEx that was embedded in our free cash flow guide. Regarding M&A, we have a very active pipeline. We are looking at tuck-in M&A. We are going to be careful about how we deploy cash, particularly in the current climate. And we will invest mainly in our digital and IP acquisitions for our Global Products, Jeff.

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Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC

Great. And just on PFAS, always fun to talk about, right, but topical today. Just pivoting more to the MDL and the like. I just wonder if you could give us a update on what your strategy is, if this recent ruling kind of against the idea of the government contractor defense in any way kind of changes your posture or how you kind of approach trying to work through a settlement here?

Olivier Leonetti

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

No change. The reserve does not include litigation recovery. The litigation is ongoing, and we believe we have a strong defense, including our government contractor defense, Jeff. We also have, as you know, insurance coverage. And at this point, we believe that any financial impact on our company is not probable and/or estimable. So, we have not reserved for this particular item.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC

Great. Thank you.

Operator: Our next question comes from Nicole DeBlase with Deutsche Bank. Your line is now open.

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Yeah. Thanks. Good morning, guys.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Hi, Nicole.

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

I just want to ask a three-part question kind of clarifying a few items in the guidance. Number one, is there any supply chain constraints embedded in the outlook versus the \$50 million you realized in 4Q? Number two, SG&A cost savings. You guys mentioned that you over executed in fiscal 2022. Just curious how much you're getting in fiscal 2023? And number three, does the guidance – could you just confirm that it does not include any buybacks? Thank you.

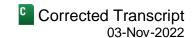
Olivier Leonetti

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

On the supply chain, we expect the supply chain to normalize half through fiscal year 2023. It's still improving sequentially, but we believe we are not going to be back to our normal state until midyear. That's point number one.

Point number two, on your SG&A, and that is embedded in our guide. We actually expect to deliver more productivity savings, and that is included in the guide we gave you, Nicole.

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And in terms of buyback, as we have said now for a number of quarters, we want to deploy 100% of free cash flow through dividend and buyback. We expect dividend to grow with earnings and the balance to be in buyback that would be about \$1 billion in buyback, Nicole, embedded in our guide.

Nicole DeBlase Analyst, Deutsche Bank Securities, Inc.	Q
Thank you.	
Operator: Our next question comes from John Walsh with Credit Suisse.	Your line is now open.
John Walsh Analyst, Credit Suisse Securities (USA) LLC	Q
Hi, good morning.	
George R. Oliver Chairman & Chief Executive Officer, Johnson Controls International Plc	A
Hey, John.	
John Walsh Analyst, Credit Suisse Securities (USA) LLC	Q
Hey. I wanted to ask you, I guess, this is a little bit about the recent CapEx your capability in US residential. Just curious if you're done expanding pro reception has been in the market with the new product?	
George R. Oliver	Λ

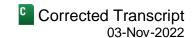
Chairman & Chief Executive Officer, Johnson Controls International Plc

Yeah, I'll take that, John. As it relates to the DOE 2023 and the cutover, we are going – everything is going well and on plan. And when you look at more than half of our residential portfolio is meeting the DOE 2023 requirements, which have been launched and we're on target to launch the remaining pieces of the portfolio before the required conversion dates. What we've seen is customers can order – place orders for the products that are already launched. And we're providing customers the opportunity to pre-buy products before they're actually formally launched.

Now, we've been working through the existing backlog and inventory to ensure a seamless transition. We are about 100% done. Cutover is complete in the south, and we're working on the cutover in the north by year-end. Commercial products are on schedule and set to launch through the balance of the calendar year. And so overall, we're on track. And I think a lot of the investment that was required to be able to meet those requirements has been put into place, and we feel very good about the way that we're executing on that.

I think as this transitions, that will provide a tailwind for us. As you know, we've had a large backlog in residential this year. We've been converting that backlog. We've been timing this transition appropriately with the launch of the new products. And we feel, as we go forward, not only do we get higher price on the new products. But as we now get our run rates better, improve now with the launch, we see significant pick up in our ability to be able to not only reduce the backlog, but be able to then take on new orders with our capacity expansion in residential.

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John Walsh

Analyst, Credit Suisse Securities (USA) LLC

Great. And then maybe just looking at the forward guidance, can you provide any color on how much of the current backlog will ship next year? Or just how we should think about the backlog conversion into next year?

Olivier Leonetti

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

So our backlog is about \$13 billion. We believe that a large proportion of that should convert next year. And again, going back to the conversation we have about the guide, that's why also our best case would be a top quartile in terms of EPS range. The backlog will give us a nice coverage. And an additional comment on the backlog. This backlog is very resilient. It's associated with very bespoke projects, which are capital tied for our customers. So, they want that to be delivered to them.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

John, let me add some color on that. When you look at our global product businesses and how that played out through the year, certainly, we had a low first half and then we had a pretty significant step up here with our seasonality in Q3. And we've continued to improve our supply chain to maintain that pace as we get into the first half of 2023. And so we've seen a nice recovery in our units. As far as our supply chain recovery, it's been across our applied and building management system products. We've had a little bit of a constraint within our residential, but, as I said earlier, that is being addressed with our capacity expansion and through the conversion now to the DOE 2023.

We've got all of our suppliers now on a recovery rate that supports a run rate through the first half that gets us positioned to recover a lot of the backlog in the first half as we ramp up for the seasonality in 2023 in third quarter. So we've made a lot of progress. Our supply chain teams have done a heck of a job working through this, and we feel confident that we'll get back to normal lead times and normal backlogs by the end of 2023.

John Walsh

Analyst, Credit Suisse Securities (USA) LLC

Great. Thank you. I'll pass it on.

Operator: Our next question comes from Julian Mitchell with Barclays. Your line is now open.

Julian Mitchell

Analyst, Barclays Capital, Inc.

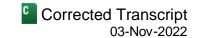
Hi, good morning. I just wanted to circle back to the guidance. I think you'd said that you're assuming only 1% volume growth in fiscal 2023. But I just wondered if you've got this big backlog and supply chain is easing, why wouldn't the volume growth be several points higher? And maybe tied to that, your guide embeds faster margin expansion early in the year than the balance, even though price/cost and supply chain get easier as the year goes on. So, just trying to understand that. Is there something assumed in the volume guide for the back half or something on mix, which is kind of pulling down the margin and offsetting the supply chain and price/cost tailwind?

Olivier Leonetti

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

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You're right. This is a prudent assumption. If you look at Q1, where we have more visibility, volume is actually 3 points of the growth, which would be back to historical average. We are planning for the year, a lower level of volume based upon us being prudent. And that prudence is also reflected in the guide in the second half as well in the best case.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Julian, let me comment on that also. In the first half, we're trying to take the backlog here in the first and second quarter. Typically, we do go down seasonally. And then, we're – given the progress we've made in the third and fourth quarter, we're trying to pick up some of that backlog in the first part of the year. Certainly, we get the leverage on that. We're – on a year-on-year compare, we get much better leverage on that. And so I think – and then, it turns.

In our field-based business, we're working to get back to our normal turn rate in our projects where with this supply chain disruption over the last 18 months, we've – anywhere from a month to two in our ability to turn projects. So we see that improving during the course of the year. So you'll see some acceleration of that in the first half as well as our units with our recovery of our product-based businesses. And so I think that's – some of those – those are some of the fundamentals that are playing out in the numbers.

Julian Mitchell

Analyst, Barclays Capital, Inc.

That's very helpful. Thank you. And then maybe a more sort of fiddly financial question. And going back to a question earlier about below-the-line items. I think one thing that maybe people underestimated was the financing charges in 2023. So you're guiding those at about \$300 million. Q4 was about \$60 million. So, is that step up more just kind of variable interest rates flowing through? Is anything assumed around the gross debt? And just wondered if there's any kind of pension impact in the P&L in 2023 year-on-year?

Olivier Leonetti

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

A

You are right about all of those. So in terms of interest, that's the by-product of the interest rate rising. We are not factoring any significant increase in the level of debt and pension income is indeed going to decline. That's the assumption.

Julian Mitchell

Analyst, Barclays Capital, Inc.

Great. Thank you.

Olivier Leonetti

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

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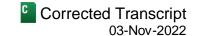
Thank you very much, Julian.

Operator: Our next question comes from Chris Snyder with UBS. Your line is now open.

Chris Snyder

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Thank you. So order momentum, clearly pretty strong through the fiscal fourth quarter. What's the outlook here on orders into 2023? At what point, should we expect this to moderate, just given the backlog and stabilizing, I think even potentially shortening lead times?

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

Well, I'd say – I'll take that. I'd say the pipelines that we're currently working on, both in direct and indirect continue to be strong. We continue to convert at the rates that we've been here in the second half of this year. We're actually projecting a very strong Q1 with orders. And so, we're watching this closely. The one area that we'll watch is in the residential space, given that we think we're at the peak of the market now and what is going to play out there.

Now for us, it's because we've been constrained with our capacity. And with the supply chain disruptions, we have not been able to convert at the rate that we could if we had the capacity. And so now on a go-forward basis with our recovery, we'll be able to take on more orders there with the new product that we're launching. And so netnet, obviously, we're watching it closely. But I think we see – we still see good momentum across the businesses.

Chris Snyder
Analyst, UBS Securities LLC

Thank you for that. And then for my follow-up, I wanted to ask on service. Just if there's anything you could provide around pricing on the service side just so we can kind of get a feel for what type of market share benefits we're seeing from the digital initiatives? Thank you.

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

Yeah. We have been very disciplined with pricing on services and not only with the traditional more of the mechanical services. But as you know, we've been enhancing our services with OpenBlue and with connectivity and new software applications. And so that's where you start to get a higher mix of service as we add on those capabilities. Overall, we've been able to more than offset the cost as we have across now all of the segments.

And so I think on a go-forward basis, as we get a higher mix of connectivity, higher mix of software services, we'll start to see a real accretion on service margin rate. But we've – obviously, while we've been expanding, we've been very disciplined on the pricing that we're getting for the value proposition that we're providing to our customers.

Chris Snyder

Analyst, UBS Securities LLC

Thank you. I appreciate that.

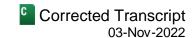
Operator: Our next question comes from Scott Davis with Melius Research. Your line is now open.

Scott Reed Davis

Analyst, Melius Research LLC

Hey, good morning, guys.

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George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Hey, Scott.

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Scott Reed Davis

Analyst, Melius Research LLC

A couple of small nits here. Is the margin structure on heat pumps kind of at scale kind of comparable to the average of the other product lines? Or is it a tad better?

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Yeah. So when you look – you got to look at the mix of heat pumps, Scott. We're about – of our HVAC portfolio, we're about 50% heat pumps and that spans pretty much all of the platforms. Now as we're creating these new value propositions around decarbonization and electrification of these units, certainly, there's a pickup in margin because there's a higher demand as we're launching these new products. And so that mix will continue to improve with the new products that are being launched.

We've seen good strength in our Industrial Refrigeration business. Even our Hitachi business has a high mix of heat pumps, and we're putting those heat pumps. We're seeing good growth in Europe as well as across the globe, actually, but a big pickup in Europe. And so as we're making the investments and the demand signals are increasing because of decarbonization, sustainability and the value proposition that these bring where we're getting incremental margins as a result.

Scott Reed Davis

Analyst, Melius Research LLC

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Okay. Helpful. And then just a follow-up on that, the prior question on price because you weren't explicit and perhaps that's on purpose. But if the average – company average is 9% price or the guide is 10%, will service – will the service and install side be close to that average, you think, in 2023?

George R. Oliver

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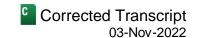
Chairman & Chief Executive Officer, Johnson Controls International Plc

No. When you look at our pricing across the segments, we've been – obviously, our book-and-build business in Global Products, we've been very aggressive, Scott, in making sure that we're recovering. With shorter cycles, we've recovered all of the costs through price and we're going to get back to the margins where we were previous to the ramp-up of inflation. On the field-based businesses within install and services, we have – with the project-based business, as you know, we – when we – you go back two years ago when we were projecting cost, we were under costing projects because we didn't factor in the level of inflation that was experienced.

Now that all was fixed a year ago. And that's been – as you see now, the mix coming through the field project-based business is very strong, right, with the pricing that was put in place as a result of now taking into account the – all of the costs and even some of the disruption costs that we're experiencing. So the project-based businesses are very high, recovering the margin that previously we were short on.

On the service-based business, it's lower because we maintain the value proposition, and we haven't seen the amount of inflation that comes through the mix of our services that we provide. And so – but again, we're offsetting cost. And then with the value proposition that we bring with OpenBlue with the digital offerings, we then

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accrete margin in addition to that with those value propositions, Scott. So it's lower than the 9% of just pure price/cost. But now, we're going to get a higher mix because of the additive services.

Scott Reed Davis Analyst, Melius Research LLC	Q
Okay. Yeah, that color is super helpful. Thank you, guys. Best of luck in 2023	3. I'll pass it on.
George R. Oliver Chairman & Chief Executive Officer, Johnson Controls International Plc	A
Thank you, Scott.	
Operator: Thank you. Our next question comes from Joe Ritchie with Gold	man Sachs. Your line is now open.
Joe Ritchie Analyst, Goldman Sachs & Co. LLC	Q
Thanks. Good morning, guys.	
Olivier Leonetti Chief Financial Officer & Executive Vice President, Johnson Controls International Plc	A
Good morning.	
Joe Ritchie Analyst, Goldman Sachs & Co. LLC	Q
So I'd like to start on supply chain. Once again, I think, Olivier, you mentione	d that the supply chain disruptions

So I'd like to start on supply chain. Once again, I think, Olivier, you mentioned that the supply chain disruptions were roughly \$50 million this quarter. I think they were roughly \$65 million last quarter. So, on the margin, things got a little bit better. But I'm just curious, are you seeing this – is this still a labor issue? Is this a component issue? Like where – what have you seen get better? And where are you still seeing constraints?

George R. Oliver

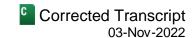
Chairman & Chief Executive Officer, Johnson Controls International Plc

Yeah, Joe, I'll take that. We've done incredible work over the last 18 months when this all got turned upside down because of lead times and all of the critical components being extended and more than double the lead times is really what started the disruption. And as a result of that, we've done a lot of good work around how do we commonize all of our components and ultimately then get aligned with our strategic suppliers and getting the volumes that we need not only short term, but supporting the growth going forward. And we've done that pretty much across all of our commodities. And obviously, the one that initially impacted us was the microchips and semiconductor materials, and we're fully lined out on that now in a good recovery position as we go forward.

And so we are seeing on a run rate basis good improvement as we're heading into Q1. And so as we've been, we've been very proactive. We've been – I would say now, as we look at our run rates of being able to reduce our backlog, we're now getting suppliers aligned and getting firm commitments that we can meet these run rates to ultimately bring this backlog down and achieve the growth that we're positioned to achieve in 2023.

Our supply chain team has done a great job. Our manufacturing sites have been keeping production going while we're continuing this recovery of materials. And we went from \$65 million in the third quarter to \$50 million in the fourth. We expect that to be reduced again in first quarter.

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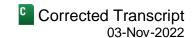


But we do – this is a – we've got everyone lined out to a recovery rate here for second quarter, so that as we position for third and fourth, which is our seasonal high quarters, we're going to be well-positioned not only to have recovered our backlog, but now to be positioned with lead times that are very competitive in our ability to be able to take on additional volume in the second half of the year. And that's what we're positioned to do.

So even though we have a little bit of headwind still with disruption, we've been pricing that disruption in our goforward pricing. And then with the offsetting some of the headwinds is the additional COGS and SG&A work that we're doing to lean out the company and offset any additional headwinds that we might achieve. But overall, I would tell you from where we are from six months ago to where we are today, we're in a much different spot.

Joe Ritchie Analyst, Goldman Sachs & Co. LLC	Q
Got it, George. That's super helpful. And then I guess maybe just one other question on the mand the margin, but the 2023 bridge. And so as you kind of think through it, I think we were origing \$260 million in cost-out. It sounds like price/cost from a dollar perspective should be positive. Askey items to really think through as we're thinking through like that's what the incrementals show 2023 versus 2022? I recognize that you guys have a low volume expectation. But are those the Or is there anything else that you would like to call out as we try to look at just like the adjusted segment?	ginally expecting Are there any other ould look like in e kind of key items?
Olivier Leonetti Chief Financial Officer & Executive Vice President, Johnson Controls International PIc	A
No, you're right. If you look at the impact of the disruption on next year, we are modeling about 0. And if you look at the incremental before – including the disruptions, the incrementals I expense at about 33% net of disruptions. Excluding them, in other words, we should be at over 40%	ect that next year to
Joe Ritchie Analyst, Goldman Sachs & Co. LLC	Q
Got it. Okay. It's helpful, Olivier. Thank you.	
Olivier Leonetti Chief Financial Officer & Executive Vice President, Johnson Controls International PIc Welcome.	A
Operator: Our next question comes from Josh Pokrzywinski with Morgan Stanley. Your line is	s now open.
Joshua C. Pokrzywinski Analyst, Morgan Stanley & Co. LLC	Q
Hey, good morning, guys.	
Olivier Leonetti Chief Financial Officer & Executive Vice President, Johnson Controls International Plc Good morning.	A

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Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Just want to follow up on that supply chain. Good morning. Just on the kind of supply chain easing and backlog conversion. During the seasonally slower period, George, like you mentioned, first quarter, second quarter, how much do you think you were able to sort of pull in as a function of, hey, maybe demand normally in these quarters wouldn't be this high, but we have extra backlog and they'll take it whenever they can get it. Is there some sort of buffer in first quarter especially that we should be aware of that's maybe kind of backlog-driven or supply chain normalization driven?

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Yeah. So when we look at backlog and we look at our run rates, we're pretty well-positioned here through the first quarter because of our backlog and the run rates that we're achieving across each one of these product businesses. We're actually trying to — on these markets that are unconstrained, meaning that there's even more growth that we can go after if we can commit cycle times that are lower. We're actually doing that to fill in additional volume later in the year. And so what we're doing is, in the first quarter, you do have less days, but we're targeting to try to maintain our run rates across all of our sites at the same level that we had in the fourth quarter.

And so to your point, does that give us an ability to be able to not only achieve the – that gives us good ability to achieve the forecast we've made. And then, as we track that in Q2, we believe that that will continue. So at this stage, we feel good about where we are and we do see continued improvement as we get through the first half of the year.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Okay. Got it. And then on the price in revenue versus price in orders, I know that was sort of a big talking point last quarter, Olivier. Just getting that sequential price or higher uptick. What was that phenomenon like this quarter, i.e., are you still getting more price in the order book than is coming out of the backlog in shipping and revenue today?

Olivier Leonetti

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

In the order book, the level of pricing has increased in Q4 relative to Q3 for our Field business. The level of orders and price into it is about 1.5 points higher than it was in Q3. So we're in the more than the mid-teens pricing in orders. So strong pricing based upon the strength of our value proposition, I would say, Josh.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Got it. That's helpful. I appreciate it. Best of luck.

Olivier Leonetti

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

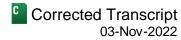
Take care.

Operator: Our next question comes from Deane Dray with RBC. Your line is now open.

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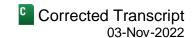


Deane Dray Analyst, RBC Capital Markets LLC	Q
Thank you. Good morning, everyone.	
George R. Oliver Chairman & Chief Executive Officer, Johnson Controls International Plc	A
Good morning.	
Deane Dray Analyst, RBC Capital Markets LLC	Q
I was hoping to get some more context on the free cash flow guide for 2023, the 80 any drawdown on working capital as the supply chain normalizes? Or is that potent target?	•
Olivier Leonetti Chief Financial Officer & Executive Vice President, Johnson Controls International Plc	A
So our guide is 80% to 90%. There are two elements into this. One to your point we grow at a steady pace. That is going to be using working capital. If you look at the rimprove all the elements of the cash conversion cycle to improve, DSO will keep improve theme now for a number of quarters, GPO the same. GIO will improve but will not go We believe it's going to be a work item in financial fiscal year 2024, Deane.	number of days, we would approving. That has been a
Deane Dray Analyst, RBC Capital Markets LLC	Q
Okay. That's helpful. And then just any color on Europe that looked like that was faithe margin, the frontlog conversion of orders, anything that you would highlight?	irly strong, but any change at
Olivier Leonetti Chief Financial Officer & Executive Vice President, Johnson Controls International Plc	A
So orders is still strong in Europe. Actually, in Q4, we see the order growth improving margin profile of Europe, it's not where we want it to be, but we see it improving as improved sequentially in Q4 versus Q3, and we expect that to be the case still as we Europe is so good I would say, Deane.	well. It has improved – it has
Deane Dray Analyst, RBC Capital Markets LLC	Q
Great. Thank you.	
Operator: Our next question comes from Gautam Khanna with Cowen. Your line in	is now open.
Jack Ayers	\cap

Hey, guys. Good morning. This is Jack Ayers on for Gautam today. Just quick question, I know the...

Analyst, Cowen & Co. LLC

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Olivier Leonetti

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

A

Good morning.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

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Good morning.

Jack Ayers

Analyst, Cowen & Co. LLC

Good morning. Good morning. I know the 2023 guide has obviously been covered here. But kind of just wanted to ask about the long-term targets provided at the Investor Day last fall. Just any color there. I know we've had some headwinds with supply chain, but it seems like things are getting incrementally better. Just how do we think about the 250 to 300 basis points margin expansion? And I guess what has to happen there in regards to the supply chain to really meet those targets?

Olivier Leonetti

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



I mean, clearly, and I'm going to state the obvious here Jack, when we put our guide, the environment was very different. Inflation, COVID, supply chain, war in Europe, FX, all those were variable which were not part of our guide. If we are – if we do not have a slowdown as – and GP of 0 to 1 next year, which is not the expectation. If we meet our base case, the guide for 2024 is still within reach, it's going to be more difficult. But if you were to do a squeeze, the revenue you need, the margin expansion you need and the EPS expansion you need to reach our target is going to be harder but still within reach. A lot will depend, Jack, on what happen this year from a macro standpoint.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

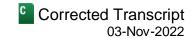


Okay. What I would say, Jack, – Jack, I'd add that when you look at the secular trends that are underway, some of these are entire recession relative to the decarbonization and the demand that we see there with a lot of the incentives that are being provided. And so, that's going to help. And we see that now playing out with heat pumps and there's a lot of different parts of the business that's benefiting from that.

Services, I think even during this period of time, services are going to be more attractive because of the value proposition that we're providing not only operationally to help our customers, but also align to being able to achieve their net zero goals. And so, there's a lot of fundamentals when you look at the space we're in and the strategy we outlined that we're confident that we're going to get to those fundamentals. It's just a matter of what is the timing because of some of these environmental events here that's having an impact on us.

But we're completely confident that we have the right product technologies combined with now OpenBlue in the way that that now is accelerating, our ability to be able to build services and recurring revenue and really attack what we see to be very attractive growth vectors, which is decarbonization, sustainability, healthy buildings and more around this whole, how do we create autonomous buildings that is an incredible value proposition that we can bring to our customers. So, that hasn't changed one bit. It's just a matter of timing with some of these environmental factors that we're weighing in.

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Jack Ayers

Analyst, Cowen & Co. LLC

That's great. Thanks, guys. Appreciate the color.

Q

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

So, with that, operator, why don't we close the Q&A? As we continue to execute, I'd say I'm very encouraged by our progress. We're in a very strong position to carry out our strategic initiatives, continue to showcase our leadership in support of our customers' mission-critical needs and we see that every day expanding.

I'd like to thank our Johnson Controls' colleagues worldwide for your continued efforts, our customers for their ongoing support, and all of you as we enter the next fiscal year on continuing to build a better, healthier and safer future in 2023. So, thank you all for joining, and I look forward to speaking with many of you soon. Operator, that concludes our call.

Operator: That concludes today's conference. Thank you all for participating. You may disconnect at this time.

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