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Johnson Controls International Plc (JCI)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Johnson Controls Second Quarter 2025 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

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

Jim C. Lucas

Vice President-Investor Relations, Johnson Controls International Plc

Good morning, and thank you for joining our conference call to discuss Johnson Controls fiscal second quarter 2025 results. Joining me on the call today are Johnson Controls Chief Executive Officer, Joakim Weidemanis; and Marc Vandiepenbeeck, our Chief Financial Officer.

Before we begin, let me remind you that during our presentation today, we will make forward-looking statements that reflect our current views about our future performance and financial results. These statements are based on certain assumptions and expectations of future events that are subject to risks and uncertainties. Please refer to our SEC filings for a list of these important risk factors that could cause actual results to differ from our predictions.

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

I will now turn the call over to Joakim.

Joakim Weidemanis

Chief Executive Officer, Johnson Controls International Plc

Thanks, Jim, and good morning, everyone. Thank you for joining us on today's call. I'm just about two months into the job, and I'm appreciative of the very warm welcome I received from the Johnson Controls team. I'd like to start by thanking our 100,000 colleagues around the world for their dedication to our customers and the work they do every day.

As you can see from our strong second quarter results, we continue to execute better across the portfolio. Organic sales grew 7%, segment margins expanded 180 basis points to 16.7%, and adjusted EPS increased 19%. During the quarter, orders were up 5%, led by continued strength in our leading applied and resilient service businesses. Overall, we grew our record backlog by 12% to $14 billion.

At a fundamental level, these results show broad-based and sustained demand for our differentiated solutions. And now, as a more focused company and with strength and execution, we're driving value for all of our customers and shareholders. Our strong performance in recent quarters, combined with a continuous momentum in our recurring businesses and record backlog, give us the confidence to today raise our guidance slightly for the full year. Marc is going to provide more details on this later in the call.

Now, I will share how I've been spending my initial weeks as CEO of Johnson Controls and some of my early observations. I will also touch on the benefits of our new organizational model and reporting segments. Before I start, my main takeaway is that I see great potential in this iconic 140-year young, technology-based and service-enabled company. I have a good sense, even in these early days, of the opportunity to further enhance value for shareholders.

First, what am I seeing? Prior to my role at Johnson Controls, I spent 13 years at Danaher, profitably scaling global businesses by building stronger capabilities and operational execution and accelerating organic growth, as well as making strategic acquisitions. I learned from that experience that the best way to get to know a business fast and in depth is to spend a considerable amount of time at Gemba. This means joining our team on the front line, where the action is and where the value is created.

Over the last eight weeks, I have visited eight countries, many customers, hundreds of our field colleagues, all of our main R&D centers and walked the floor in 15 factories. I am becoming ingrained in the business; getting up to speed on the needs of our customers, markets, competitors, technologies, services; and assessing our capabilities in operational and growth execution, talent and strategy.

So, where are we now? It's clear to me that Johnson Controls has considerable strengths. First, our market-leading franchises such as our YORK HVAC business and our Metasys building automation controls platform. Second, our talent in the field is a true differentiator. We have over 40,000 dedicated and customer-oriented employees. Finally, our technological capabilities and our product domains are impressive. Our capabilities are evidenced by our many industry-firsts and nearly 8,000 patents, with more coming.

Johnson Controls has come a long way over the last several years. But as I said, there's still great potential to unlock in this iconic technology-based and service-enabled company. An important step in achieving this is our new structure. Let me discuss our new organizational model. Johnson Controls has been undergoing a lot of change the past few years, including the pending sale of our Residential and Light Commercial HVAC business. We have now evolved our operating model, which is an important first step to make us a more customer-centric organization.

As you can see on slide 5, we have reorganized into three geographical customer-oriented reporting segments, which are supported by leading global functional capabilities. Our goal is to achieve market-leading performance and build a faster-growing and more profitable company by strengthening how we serve our customers, improving our operational performance, and accelerating innovation.

Our three geographical segments serve as our consolidated commercial engine, regardless of channel strategy, responsible for improving customer intimacy and market reach, while delivering profitable systems and lifecycle solutions growth. The geographical segments are supported by two global centers of functional excellence. The products and solutions group is tasked with accelerating our rate and speed of innovation and improving our operational performance in supply chain and manufacturing. Our commercial and field operations team is tasked with building capabilities in all commercial areas by deploying best practices and tools, which enables our regions to grow faster by finding and winning more customers, while improving how we serve them over the lifecycle. This organizational model clarifies and delineates roles and responsibilities in a much better way, and it is the right next step for Johnson Controls. We're looking forward to realizing its benefits.

With that, as I said, I have a few initial impressions to share. First, throughout my travels, I can see that there are opportunities for us to focus a lot more on our customers and our competition in all functions and layers in our organization. I'm encouraging everyone at Johnson Controls, from customer-facing to senior leadership, to prioritize winning with our customers and to act with speed and urgency. This emphasis, coupled with our new operating model, will allow us to build a more agile, faster executing, and thereby faster growing and more predictable execution engine.

Second, our operational and innovation execution is slowed by complexities in our current product offerings, number of SKUs, footprint, and operating methods. This can be unlocked with tried and proven Lean and business system approaches. As some of you know, Lean is about orienting and aligning an entire organization around our customers, involving all employees in waste elimination and continuous improvement to build capabilities, better processes, and speed. In short, a winning execution engine.

Third, I'm taking an objective, fresh look at our strategy and how to best further optimize our portfolio. I will share more at a later point in time about what I think is good for Johnson Controls as I deepen my understanding of our businesses and markets and customer needs. I still have a lot of listening and learning to do. I want to continue to do it where the real value is created, at Gemba. We are building on a solid foundation. And I believe with more relentless focus on customers across our organization, as well as on Lean-enabled execution fundamentals, we will be able to drive accelerated value creation.

We have a unique offering and an enviable service capability that is driven by our culture of innovation. Johnson Controls will continue to redefine building performance, driving the next era of smart, safe, sustainable, and autonomous buildings, and powering our customers' missions.

And with that, I'll turn it over to Marc to cover the quarter. Marc?

Marc Vandiepenbeeck

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

Thanks, Joakim, and good morning, everyone. Please turn to slide 6. Our fiscal second quarter was strong across the board. Our team has worked diligently to navigate dynamic market conditions and capitalize on opportunities in front of us. We remain focused on driving consistent, predictable growth and delivering value to our shareholders.

Organic revenue grew 7% and segment margin expanded 180 basis points to 16.7%, led by enhanced operational efficiencies and higher volumes. Adjusted EPS of $0.82 was up 19% year-over-year and exceeded the high end of our guidance range. The strong first half of the year reflects our team's ongoing dedication and strategic execution.

On the balance sheet, we ended the second quarter with approximately $800 million in available cash, and net debt decreased to 2.4 times, which is within our long-term target range of 2 to 2.5 times. Adjusted free cash flow for the quarter was strong, resulting in an impressive increase of approximately $1.1 billion year-to-date. This improvement, supported by strong working capital fundamentals, underscores our effective financial management and solid operational performance.

Let's now discuss our segment results in more detail on slides 7 through 9. Beginning on slide 7 and 8, our Building Solutions region delivered another solid quarter. Our order grew 5% in the quarter, despite facing a tough comparison and the impact of accelerated orders in the prior quarter due to global uncertainties. This growth underscored the sustained customer demand for differentiated solutions and services.

Geographically, orders in North America increased 4% in the quarter, with mid single-digit growth in both systems and service. In EMEA/LA, orders were up 10%, with 13% growth in service and 8% growth in systems. In Asia-

Pacific, orders were flat as we continued to implement our strategy in China, prioritizing the booking of profitable system projects with upfront payments. Meanwhile, service orders grew nearly 20%.

Organic sales increased 7%, with solid high single-digit growth in both systems and service. Sales in North America were up 7% organically, with continued strength in both HVAC and controls. In EMEA/LA, organic sales grew 5%, led by 9% growth in service. In Asia-Pacific, sales grew 13% organically, with strong double-digit growth on both systems and our resilient service business. Margin for Building Solutions has been steadily improving over the past few quarters, and we continue that trend this quarter. Our focus on operational efficiencies and an optimized service make a significantly boosted profitability.

By region, EMEA/LA adjusted segment [ph] EBITA (00:12:26) margin expanded 410 basis points to 12.5%, driven by improved productivity and a positive mix of service growth. In APAC, adjusted margin expanded 360 basis points to 14.6% as productivity and mix improved. In North America, adjusted margin declined 20 basis points to 13.4%, as system growth outpaced service growth. The higher system growth was a positive contributor to the overall margin expansion within Global Products. Building Solutions backlog remains at record levels, growing 12% to $14 billion. System backlog grew 12% and service backlog grew 9%.

Turning to slide 9, Global Products continued to build momentum and delivered another strong quarter of growth and margin improvements. Organic sales grew 8% as price remained positive and we delivered 6 points of volume growth. Applied HVAC grew more than 20%, with strong double-digit growth in North America and EMEA/LA. Adjusted segment EBITA margin expanded 600 basis points to 30.3% as our improved operational efficiencies drove considerable margin enhancements.

Let's discuss our fiscal third quarter and full year guidance on slide 10. Our second quarter performance and continued growth in our orders and backlog position us for continued success in the second half of fiscal 2025. For the third quarter, we anticipate organic sales growth of mid single digits. Adjusted segment [ph] EBITA (00:14:09) margin of approximately 17.5% and adjusted EPS in a range of $0.97 to $1.

For the full year, we are maintaining our guidance for organic sales growth of mid single digits as our continued strength in orders and our resilient backlog provides visibility into the second half. With our strong start to the year and continued improvement in our operational efficiencies, we are raising our full year guidance for margins, adjusted EPS and free cash flow conversion. We now anticipate adjusted segment [ph] EBITA (00:14:44) margin to expand roughly 90 basis points and adjusted EPS to approximate $3.60 per share, representing roughly 12% growth.

Our working capital metrics have consistently improved and our free cash flow performance has been strong year-to-date. As a result, we now anticipate achieving free cash flow conversion of approximately 100% for the full year. We continue to target returning 100% of our free cash flow to shareholders through dividends and share repurchases.

Lastly, our updated guidance considers the current geopolitical environment, including tariffs. Based on the regulatory environment as we know it to date, we believe our annualized exposure to tariff before mitigating actions is approximately 2% of sales or 3% of cost of goods sold.

As you can see on slide 11, we have activated many levers to enhance our resiliency and mitigate the expected impact from tariffs. This includes strengthening our in-region, for-region manufacturing strategy, dynamically transforming our supply chain by pivoting to local sourcing, accelerating our pricing action and asserting our contractual right to the change holders. We believe by leveraging the strategies, coupled with our long-cycle business and resilient service mix, we have the capability to navigate the complexities of the current geopolitical landscape and continue to deliver strong performance.

Before opening the lines for questions, I would like to turn the call over back to Joakim for a few additional comments.

Joakim Weidemanis

Chief Executive Officer, Johnson Controls International Plc

Thanks, Marc. I'm truly excited to lead this iconic company into this next chapter. As a more focused company, we have a great foundation to build upon. Looking ahead, my initial priorities are to increase our team's focus on customers and continue to develop and strengthen our ability to execute for the customer.

I would like to take a moment to recognize and thank Marc for his continued impact on Johnson Controls, not just over his nearly 20-year career, but in particular as our CFO since January 2024. While we've only worked together for just shy of two months now, he is a strong partner and has helped me get up to speed. I enjoy partnering with him and look forward to continuing to do so. I also want to recognize George Oliver for his support as I stepped into the role as CEO and for his significant contributions over the last eight years. He has set us up well for our next chapter.

Finally, I'm looking forward to engaging with many of you, the investors and analysts that I have crossed paths with since earlier in my career at Mettler Toledo and then during my 13 years at Danaher. I expect to continue to seek your input and perspectives as part of my effort to build transparent and constructive relationships. My goal is to help our team unlock the true potential and build a winning, sustainable, high-performance company as measured by all of our stakeholders.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] And our first question will come from Scott Davis of Melius Research. Please go ahead.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Hey. Good morning, guys.

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

A

Morning, Scott.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Joakim, welcome to your first call.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Thank you, Scott.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Hey, I know this is a little bit of a conceptual question, but how do you plan to kind of launch Lean or deploy Lean, I should say, in an organization this large? And maybe the better question to ask, really, is how ready is the organization? Have they already been – has there already been some Lean implemented, and how broad [ph] – I guess (00:19:06) I'll just kind of open it up to that.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. Thanks for that question, Scott. And I know you are one of several people on this call who's quite familiar with what Lean is about, but just a reminder, it's an approach to align an entire organization towards the customer, and then involving all of your people, not just manufacturing, but everyone in waste elimination, building stronger processes, capabilities, so that you can execute faster for the customer, and in doing so, becoming faster and more competitive, but also, of course, taking out cost and capital.

So to answer your question, I mean, the interesting thing here is that with – and it was a long time ago, but some of the automotive connections, there are some remnants of Lean in a few places in this company, but the foundation is not very strong, but the interest is there. People have seen some of it in the past, so there's an open-mindedness to it, which is great. That's not always the case, as – in my experience with all the acquisitions that I've been involved in over the years. So, I'm happy to see that.

Now, where do you start? I mean, you typically pick a value stream, for example, a product line, and you take an end-to-end approach, starting with the customer, all the way through your installation, all the way through the factory, all the way back to suppliers, as well as the order entry phase and so on. And you basically value stream and map issues, opportunities for improvement. And already in my first eight weeks here, it's fairly clear what a couple of value streams would be, where we're going to start.

And as a matter of fact, we have already started slowly working on one value stream. So, it's a matter of prioritizing. You can't boil the ocean and do it everywhere. You have to pick a value stream at a time. But I'm really excited about it. I see that there are tremendous opportunities for us here applying Lean execution fundamentals.

Scott Reed Davis
Analyst, Melius Research LLC

Q

So, Joakim, just to follow up on that, I mean, you mentioned the too many SKUs or too much complexity in the SKUs, kind of either way. Do you expect those value streams to kind of lead you down the path of SKU rationalization? Or is that a...

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah.

Scott Reed Davis
Analyst, Melius Research LLC

Q

...separate kind of hurdle?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

No, you do it together. So, as you're taking it on, the value stream, I mean, you will discover, as you go map the challenges that you have in that value stream, fairly early in my experience, you'll find those kinds of complexities. And so, we'll go after them. Now, we have a separate exercise that we've started attacking the SKU proliferation that we have. So, there's some low-hanging fruit that we can go after before we start attacking each value stream.

Operator: The next question comes from Steve Tusa of JPMorgan. Please go ahead.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Hi, good morning.

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

A

Hey, Steve.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Good morning, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Congrats. And I guess, just thinking about that a little bit of a step further on the entitlement of these businesses, I think we've looked at it in the past as perhaps JCI has a lower margin entitlement due to its business model of a bit more kind of field labor projects. How do we think about the entitlement of this business? Can we look at some of the publicly traded peers and think about your margins being able to go there? Or is there some sort of ceiling due to the business model that you see?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

The way I see it, Steve, is that in addition to the product side, we have tremendous opportunity on the margins in the field as well. And this value stream mapping that I was talking about applies to how we can approach both unlocking further growth as well as margins in the field. And of course, there are also not just process, but there are digital tools and approaches available to us that could enable us to grow the margins very nicely in the field. So, I don't see that we would have a bigger limit on the margin expansion here than any of our peers. Not at all.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. Got it. And then as far as portfolio is concerned, how do you think about this portfolio? Do you like the construct with fire and security and HVAC and controls integrated, or is that something that you're poking around at as well?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

So, I mean, I'm here to create shareholder value. And then, the first thing you have to do when you're looking at portfolio, which is looking at what you have or potential acquisitions, you need to start with strategy, of course. So as I mentioned in the introduction here, I am taking a pretty deep and fresh look at our strategy for the entire business as well as the individual pieces. And I'm just eight weeks in, but of course, you see some patterns and you draw some conclusions already. Now, you need to be a little careful because I am only eight weeks in. So at the appropriate time, I'll come back and share more of what I've learned and what I think is the right thing for Johnson Controls.

Operator: The next question comes from Nigel Coe of Wolfe Research. Please go ahead.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Thanks. Good morning. And Joakim, appreciate the open remarks. Very helpful. I wanted to actually start off with free cash flow because you raised the guidance to about 100% with obviously very strong performance in the first half of the year. So, I'm just wondering, obviously, that's been a big initiative for you, Marc, to improve the free cash conversion. So, what is the right level going forward? Are we now at a point where free cash conversion can be at that 100% level in 2026 and beyond?

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

Hey, good morning, Nigel. You're right, we very confidently raised our guidance from the 90-plus to now about 100% this year. We had a very strong start of the year generating that $1.1 billion in the first half. You followed us for a long time. You know, historically, that first half used to be flattish to a slight free cash flow generation. $1.1 billion is a very strong start and is really a demonstration that our operating model, the strength of our working capital structure, and how we've continuously improved our processes, really start generating value across the entirety of the working capital, whether it's our receivable, ability to build and collect on time, managing our payables, but particularly working on our inventory and not having to build too much inventory as we continue to grow fairly rapidly.

Those working capital metrics continue to improve. We have those fundamental headwinds that we've talked about that are not changing in the coming couple of years. So, I think it's a bit early for me to tell you like we're going to be 100% all the way forever. But I think I see good signs for us to be solidly in the 90s and probably better as we continue to improve those operational efficiencies through the working capital.

Nigel Coe
Analyst, Wolfe Research LLC
Q

That's great to hear. And then, Joakim, I know it's early days and you've been in the seat for eight weeks, but Danaher is obviously a company that devotes more like 100% of its free cash flow to acquisitions, and JCI's commitment is more on the returning capital to shareholders. So, where do you stand on capital allocation going forward? Do you think the scope for JCI to be more acquisitive or are you committed to that shareholder return?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

So, I think the work I'm doing on the strategy together with the team here is going to help us answer that question. Now, I do think that there are opportunities with some of our franchises to continue to differentiate with a technology angle. And so part of the strategic work that I'm doing is to explore how to do that at pace. But like I said, I'm digging into the strategy right now. I'm taking a fresh, independent look from the past, if you will. And then based on that, when I'm ready, I will come back and talk more about what that means for the capital allocation strategy.

Operator: The next question comes from Amit Mehrotra of UBS. Please go ahead.

Amit Mehrotra
Analyst, UBS Securities LLC
Q

Thanks. Morning. Welcome, Joakim.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Thank you.

Amit Mehrotra
Analyst, UBS Securities LLC
Q

Joakim, as you think about positioning the business for higher returns, I guess I'm trying to understand the drivers of that between cost out and cost leverage. Specifically, is there an opportunity for absolute cost takeout, which I assume could be executed on relatively quickly? Or is this really more about leveraging the existing service network and service cost base via higher service attachment, which obviously seems like maybe it's a little bit more of a longer cycle journey? I'm just trying to – we're Wall Street analysts, so we're not very patient. And so, as a result, we want to calibrate my expectations or our expectations on what the organization can do, if anything, in the near term to improve margins.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. I think the reality is it's a situation that we're going to be doing both. And I've seen this situation before, by the way. So if we take the field, the service capabilities, we have 40,000 people in the field, they're in sales as well. But there – I would say, there, it's more about cost leverage. It takes decades to build a field position that we have. I mean, it's really an enviable position. So there, it's more leverage. So there, we'll be working on process efficiencies, getting more capacity out of the people that we have, digital approaches as well as service offerings.

And then, applying Lean principles, which is really about, like I said, removing waste, increasing speed, and being able to execute more predictably. But as you do that, you invariably find cost takeout and capital takeout opportunities. So, I think away from the field, it's a combination of leverage. But there's where you're probably going to see more cost takeout.

Amit Mehrotra
Analyst, UBS Securities LLC

Q

Okay. And then just maybe one for Marc, if I could. So just with the pending divestiture of Resi/Light Commercial, I just think the business is obviously evolving into a much more longer cycle business. And I'd be curious to kind of understand, as you enter into new contracts and orders, how you manage the pricing of those contracts, just given the backdrop of inflation and obviously tariffs. Basically, how do you just ensure the pricing of the backlog reflects some of those uncertainties and kind of moving parts?

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

A

Yeah. So, over the past couple of years, we've implemented very strong contractual terms that allows us both to reprice as we see potential inflation, but also manage better change order. As you might have gone through the history, we had some delay in our ability to execute on our pricing strategy earlier on during the high inflation periods. We've now completely [ph] re-overhauled (00:31:34) our approach there. And it's not just our contractual term, but it's our ability to execute on those change-order and get after the benefits you're entitled under your contractual agreement, and all of the processes that come behind on being able to actually price, cost, and defend to the customer the value you've generated for them.

Operator: The next question comes from Joe Ritchie of Goldman Sachs. Please go ahead.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good morning. And welcome, Joakim.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Thanks.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Looking forward to working with you.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Thank you. The same.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. So, look, I know it's early days, and I also recognize that the Lean journey is one of continuous improvement. The company right now has signed up for some really nice margin expansion this year, right, the 90 basis points. I'm curious as you're thinking about kind of like the medium-term opportunity. I know, again, early days, should we be expecting some similar level of margin expansion beyond this year? Just any way that you can either help quantify or maybe come back to us at a later date on how you're seeing the opportunities develop.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So, I see very interesting opportunities to both accelerate growth and improve margins. And I talked a little bit about how I think – by shifting, how we work, being much more customer and competitor oriented, and implementing Lean approaches to improve our operational execution. So, I think we're going to see both, as we discussed here, opportunities from leverage of resources, assets that we already have, as well as cost reductions.

I'm actually really excited about what we could do here over the next couple of years. And I really see no reason for why we couldn't reach or surpass over time. And I will come back to the timing of that where some of our competitors are at today. And I will have to think about how quickly we can get to some of the profitability levels that prior businesses that I've run, and I'll have to come back to that at a later point in time. But I see us as having really, really compelling opportunities here.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Great. Yeah. That sounds great. We'll be looking forward to that update. And then, maybe just on the fundamentals of business today, I'm curious just there's been still a lot of consternation around data center growth. We ended up visiting you guys at Data Center World a few weeks ago. It also sounded like you were in the process of potentially coming out with a liquid cooling product. And so, can you just maybe just provide an update how that business is trending, what the expectations are for just investments and new product rollouts? Thank you.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. Sure. So, that's one I have been able to dig into in depth. And I've met with many of our – the largest customers that we have. So, here's actually a part of the company where we have been more customer oriented, I would say, than in other parts of the business. And I don't mean to suggest that we're not customer oriented overall. I'm suggesting we can be even more customer oriented. But here in the data center business, as some of you probably know, we've worked with some of the largest customers with their engineering teams over the last couple of years to help them design their architecture of their data centers. And so, we're working very closely with them.

And the reason we have been invited and are doing so is our differentiated high-performance YORK chiller platform, efficiencies, water consumption, and so on. And so, we have a very good position in this market. And the demand, as many of you have written about, continues to be very, very healthy. And we don't see that decreasing the rate of growth there at all over the next couple of years. So, we're super excited about our continued growth there and what we can do based on the differentiation we have today.

And maybe I could add a little bit more color. That market, of course, as many of you have written about, is – a large part of it is the North America, but a growing part of it is an Asia-Pac. Europe is a little bit behind from a market point of view. I'm not talking about our sales now, but the market. And as our large global customers have started to expand into Asia, because of the work that we've done with them here in North America, we are already – they know we're already there with feet on the ground with our service capabilities, which – because these are more mission critical applications, the service capabilities are incredibly important.

So, we're capitalizing on that as well as investing, not just in manufacturing. I think that's something we've talked about probably at prior calls, but we're also investing in the field here with specific data center competencies. So, I'm really excited about what we're going to be able to continue to do in the data center world.

Operator: The next question comes from Julian Mitchell of Barclays. Please go ahead.

Julian Mitchell Q
Analyst, Barclays Capital, Inc.

Hi. Good morning, and welcome, Joakim. Maybe the first question is just on the margin outlook in the short term. So, your operating margins were up, I think, close to 200 bps in the first half year-on-year. Second half looks like it's guided sort of flattish year-on-year. Just wondered, how much of that is a tariff margin rate headwind? How much is maybe something going on with mix? And BSNA, certainly the margins were down in the second quarter. Any sort of thoughts on how that plays out from here, please?

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

Yeah. Great question, Julian. So, on the BSNA element here, as I mentioned in the opening remarks, some of that leverage, you see the improvement in margin at Global Product benefiting from the volume that BSNA has managed to pull through. And as we re-segment, and that's one of the big reason to do such a thing, is you're going to have a more harmonized view of how the Americas will look like. We've shown you a little bit of the historical pattern, but very shortly we will issue how the second quarter shaped out under that new re-segmented view of the business. And you will see that benefit in that continuous improvement in margin coming through the Americas segments.

As far as how we've guided the balance of the year, you're right, there's a – on a margin rate standpoint, we have taken an approach where we are recovering the vast majority of the impact that we see from the tariff environment, but we are not applying margin on a lot of that. And what that comes down to is it puts a little bit of a damper on our ability short term to improve that margin, but it doesn't really change that momentum over time. As we continue to take a lot of actions on simplifying our operating model and leaning out of cost structure, I think we will see some further upsides as we navigate through that tariff momentum in the next year.

Julian Mitchell Q
Analyst, Barclays Capital, Inc.

That's great. Thank you. And then maybe one for Joakim. Maybe just sort of fire and security market, it's under-grown HVAC for some time. I think this quarter, sort of flattish sales in BSNA, up only low single in Global Products. You called out the franchise strength at the beginning in YORK and Metasys. So just wondered, sort of what are your initial impressions of the fire and security portfolio? I imagine there's a very broad range of performance and metrics within it, but any sort of broad brush perspectives and how easy do you think it is to rejuvenate growth there?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah, I think those are – the fire and security franchises are also strong franchises for us. And what I have to learn more about is, as you pointed out, what is the growth acceleration potential there? And so, I think it's a little too early for me to offer a conclusion on that. But part of my strategy work is trying to understand what could we expect to realistically get out of the individual franchises? And so, I'll have to come back on that. But as many of you know from Danaher, not all franchises grew at the same rates. Not all franchises had the same profitability levels or cash flow contributions, right?

So, I'm thinking about could there be different roles that different parts of the portfolio plays for us, right? Not only in terms of what should we be in or what should we not be in, right? So, I'm taking a rich, fresh, dispassionate look at our strategy and what's possible in the market with what we have. And based on that, I'm going to come back and share with you at the appropriate point of time what I think it is the right thing for us to do.

Operator: The next question comes from Noah Kaye of Oppenheimer. Please go ahead.

Noah Duke Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Hey, thanks. Marc, I just want to follow up on Julian's question around the margin impacts. So, is it possible to kind of dimension for us the assumption around the gross cost inflation or even the net cost inflation as a margin headwind?

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

A

Yeah. I would think about it not so much as a headwind, but as a dampener in our ability to continue to expand margin. If you look at the second half, our anticipation is the America segment was going to be able to drive further margin expansion. And as we have to pass through some of that impact of tariff, whether it's a [ph] $1-for-$1 (00:42:40) or sometimes just changing a little bit of supply chain and incurring some short-term costs as we pivot some of that supply chain to a more localized or regionalized product solution, we end up with some costs that we can recover dollar for dollar, just not apply a gross margin rate and not making an earnings opportunity.

As you know, for a lot of our businesses, we enter into relationships that last multiple decades as that piece of equipment gets serviced throughout the lifecycle. And we want to be remembered as a team that managed and navigated through the tariff situation in a manner that our customer will continue to perceive as fair, balanced, but where we have to recover dollar-for-dollar or cost impact without trying to get margin on top.

Noah Duke Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Appreciate that strategy. And then, Joakim, you talked at the beginning about the streamlined operating model really going through the regions. You also mentioned the data center business as a very good example of where

JCI is strong. And I think back to a little under a year ago when it was basically a global organization formed around sort of excellence in go-to-market and data center. So, just thinking about that as an example, is there a blueprint here for creating any kind of new infrastructure within the company from a sort of product or go-to-market perspective at a global level? And where might that focus be, if so?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

No [ph] new – (00:44:26) I don't have any new structures in mind in addition to what I discussed here earlier. But within that structure, there are dedicated resources on the regional side for major verticals. And data center is a major vertical. And on the product and solution side, there are, of course, the R&D engineers, teams dedicated to data centers. And some of our factories happen to have manufacturing lines dedicated to data centers. So within that structure, of course, there will be, for the verticals or customer groups, where it's warranted, there will be teams that are a little bit more dedicated.

And so, what I would anticipate, though, is that in addition to data centers over time – and we'll see what my strategy work leads to exactly here, but I would expect that in addition to data centers that we might have a few more vertically oriented teams, within our regions and global products and solutions, and it, obviously, focused on verticals where we believe that there are larger and more imminent growth opportunities. So, I think the structure overall is set. And then how you activate it for particular growth opportunities within the structure, we might choose to focus on resources, just like we've done for data centers, and we'll continue to do so.

By the way, I mean, that's our structure here. I don't want to downplay what we've announced, but it's sort of a very logical structure and it's one that, of course, is tried and proven and that I've seen and worked with in other companies, right? And so, what I just talked about there is based on my personal experience in other industries where you had multi-vertical plays, but you needed to have global geographical coverage, you needed to have R&D teams that are focused on technologies, platforms. But when it comes to applying them in specific vertically oriented products, you need to organize a little differently inside these teams. So, it's a well-tried and proven approach that I'm very familiar with the way what I've talked about here.

Operator: The next question comes from Chris Snyder of Morgan Stanley. Please go ahead.

Christopher Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. I wanted to follow-up on some of the data center commentary. Obviously, a market that you guys have been in for a long time, but just given the, I guess, more rapid growth than history, it does feel like there are maybe new entrants or new competitors more focused on the market. Has there been any change in the competitive environment in data center versus two or three years ago? And what could that mean for JCI? Thank you.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

So here, I'm going to have to defer to Marc, because I'm eight weeks in, so I've done a lot of studying of who's in it now. But Marc.

Christopher Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Fair enough.

Marc Vandiepenbeeck

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

A

I think, Chris – yeah, and the way you need to think about the data center market is, yeah, of course, it's a very attractive market. Commercially, it's the fastest growing market. And so, a lot of adjacent industries have started to look at cooling as an opportunity for them to expand. I think that's where the 140-year experience in creating differentiated solution for customers and our technological advantage plays a critical role. So, yes, you've seen new entrants over the last two, three years coming in with products that are very attractive, but don't create the technological advantage that we've been able to get to.

We have a particular YORK product that has a very wide operating range and that provides to a customer a global single platform where they can expand and standardize their infrastructure. And that ability to continuously engineer, iterate, and improve on the leading product, I think, provides a real differentiated value for customers.

Christopher Snyder

Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Joakim Weidemanis

Chief Executive Officer, Johnson Controls International Plc

A

Yeah. And I think maybe if I could add to that. I mean, I was at our global R&D center for high-performance HVAC chillers here on Friday, digging deep into our technology capabilities. And I mean, at the end of the day, with the new entrants and new evolutions of how you configure a data center and so on, there will be more opportunities for us. But at the end of the day, you need to get heat out of that server room. And at the end of the day, our chiller – it's kind of like the aircraft engine. You need the highest-performing aircraft engine that doesn't take power away, because you want power to drive the chips, right? And to design and manufacture a high-performance chiller, think aircraft engine, at the levels that we're performing, that is not something you learn in 10 or 20 years. This is built on unique know-how that we've developed over decades. And it's not just the know-how, it's also how our products are configured.

And I don't want to go into all the details of that right now, but obviously having this know-how, there are parts of the chiller, our technology-based differentiation is built on that we don't buy off-the-shelf parts, like new entrants or other people might do. So, we've designed modules that are application-specific, and thereby we're able to just eke out more performance out of our high-performance chillers than many other people can. So from a chiller point of view, there's going to continue to be a great need for high-performance chillers, and this plays to our strengths. And everybody's continuing to evolve, of course, but I do think we really are very well-positioned here.

Christopher Snyder

Analyst, Morgan Stanley & Co. LLC

Q

Thank you. I appreciate that. And then maybe just following up, and I'd be interested to hear your views on installation. There's always a lot of question and focus on JCI's installation business.

Joakim Weidemanis

Chief Executive Officer, Johnson Controls International Plc

A

Yeah.

Christopher Snyder
Analyst, Morgan Stanley & Co. LLC
Q

And then, any color on just the ability to make sure that installation is ultimately kind of being the engine that's driving the aftermarket service side of the house. Thank you.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Sure. I think that's one of those questions that's not black and white, right? So, part of my strategy work that I'm doing right now is that exact topic. And I'll give you an example of how we approach that. I mean, it's very pragmatic. We're taking a look at hundreds of projects where we did different degrees of installation, because we don't always do 100% of all the installation for our products, right? And then, we're looking at the financial performance of that. We're looking at how competitive we were with or without installation. We can see that from our pipeline data. And then we're looking at the actual, in the real world, linkage to service contract attachment, and to answer some of the questions that you're raising here. And I think that's where – it's time to do that.

And I would expect that the conclusion is going to be not black and white either. I think the conclusion most likely is going to be that under these and these circumstances for these and these types of customers, for these and these types of products, installation with this and this scope makes sense for us competitively, financially, and from a service attach point of view. And very likely, we'll conclude that in some other instances, it does not make sense. But I think we're just trying to develop greater clarity on how to win, how to execute, and not just with the systems upfront, but of course, over the life cycle.

And I'll come back at a later point in time and share more details about that. It's hardly a unique situation, by the way. I've seen this kind of situation in other businesses in my career. So, I'm actually excited about – this is one simplification. When I was talking about simplification and complexities, this is one area that we're digging into under that top – headline.

Operator: The next question comes from Andrew Obin of Bank of America. Please go ahead.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Hi, guys. Good morning.

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

Hey, Andrew.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Good morning.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Hi. Good morning. Welcome.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Thank you.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Yeah. So, just a question I want to applied. You definitely called out strength in data centers. What are the other verticals driving applied growth? And are there any verticals sort of creating [ph] headwinds (00:54:00) that you're worried about?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

So, broadly, I mean, most of our verticals are actually performing pretty well. I mean, I also read perhaps some of the same industry reports that some of you read, Dodge, ABI, and so on. And so, a few weeks ago, I started to not just look into how we're performing by verticals, which is sort of a rearview mirror, the orders and the sales, but also looked at leading indicators to try and understand what might be coming our way. And so, really the conclusion is that fairly broad-based, good growth.

And in terms of the leading indicators, at this point in time we don't see any slowdown in some of the areas that you might think there would be slowdowns in based on Dodge and ABI. Now, of course, we're exiting Light Commercial, so – with the divestment coming up here. So, obviously, I'm not commenting on that when I make these comments here. So...

Operator: The next question comes from Nicole DeBlase of Deutsche Bank. Please go ahead.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.
Q

Yeah. Thanks. Good morning, guys, and welcome to the call, Joakim.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Hi. Thanks, Nicole.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.
Q

I guess maybe just starting with a question on price versus volume, presumably with tariffs coming into the fray in the back half, you guys have probably raised your expectation for pricing, I'm guessing. Did you embed any sort of contingency with respect to volume just because of all the macro uncertainty? Or are you taking a view, hey, we have a really robust backlog, as you mentioned, the leading indicators look good, and so there's no expectation of significant volume decel in the back half?

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

If you look at, first of all, how we think about price versus products, particularly in our Building Solutions business, the scope of that business, each job vary year-on-year. And so, it's not so much about the number of units you sell, and the volume/price dynamics become a bit complicated. It's more about the value you're providing to the customer. And if we are pricing appropriately, then you see the margin continuously benefit from that.

In terms of what we see from a macro level, the level of macro uncertainty remains pretty high after all of the tariff impact. And while we are mostly a long cycle business, whether it's on our systems or service businesses, we still have, call it, 25% or so of the company that's shorter cycle in nature. And we have built in some perspective on what could potentially happen to some of our end markets and vertical, as some of that uncertainty is built into our guide.

Operator: The next question comes from Andy Kaplowitz of Citigroup. Please go ahead.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Hey, good morning, everyone.

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

Good morning, Andy.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Good morning.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Apologize if this has already been asked. I came on late, but just wanted to focus on service for a second. I know it's been a big priority for JCI over time. Joakim, as you come and look at the business, where do you think attachment rates can go over time? And what does JCI have to do to sort of continue to improve attachment?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Yeah. So, first of all, as you know, we had very healthy service growth, and we have had that over some time. And you may have heard that I also think that our 40,000 people in the field is really in an enviable position to have. That's something that's been built over decades, right? And as some of you asked, in terms of margin improvement and so on, when I answered that what could we do in the field? I think there it's more about leverage. How do we build more capacity with Lean approaches, process improvement, digital approaches, and so on, so that we can get even more out of our field colleagues, not just capacity, but response time as well, which is an important element when you're in a service business, right? It's menu and time to respond is what defines your competitive advantage, right?

So, I think if I look at some of the attachment rates that we have in some of our businesses today, I see very interesting opportunities for improvement. And I don't want to go into exact numbers right now. Maybe I can come back to that at another point in time. But I don't see why we couldn't move the attachment rates to something much higher than where we're at today over time. So as excited as I am about applying Lean overall, just a reminder for everyone, I'm not talking about factories only, right? Of course, I'm including that, but I'm thinking about applying Lean in our service businesses as well as all of our back offices and in the corporate overhead as well over time here. But I [ph] – hey (00:59:48), service, I think, is a tremendous opportunity for us.

Operator: The next question comes from Deane Dray of RBC Capital Markets. Please go ahead.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Thank you. Good morning, everyone. And I'll add my welcome to, Joakim.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Hey, Deane, how are you?

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Hey, I'm doing really well. You're – almost have your first conference call under your belt. So, congrats.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Thanks, Deane.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Hey. In the interest of time, I'll keep it to one question. And the surprise for us in the release today, it's a pleasant surprise, that your guidance is a single point of $3.60. And you still have the back half of the year to go. That's pretty precise. And this is a quarter where a number of industries are actually pulling guidance. And you're doing kind of the opposite, which speaks to a question about your degree of confidence and the earnings visibility and the backlog strength and so forth. But how does that all to come – come together and what's your thoughts on earnings visibility?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Yeah. Well, first of all, maybe I should say, I think, of everything I've read, you should not increase guidance when you're the new CEO. But then, as Marc discussed here, and as I said in my commentary, we do have very good visibility. Some of our – parts of our business is long cycle, right? And then, the recurring part of our business is a significant part as well. So if you do the math, we're in a good position here. And I've gone through this math with my partner, Marc, here multiple times, going back to my first comment.

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

In great details.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

And so, it's really based on how we're positioned with the backlog, the long cycle and the recurring, and the actions that we've already started to implement on the tariff countermeasures, as I mentioned here. So, that's kind of the background.

Operator: This concludes our question and answer session. I would like to turn the conference back over to Joakim Weidemanis for any closing remarks.

Joakim Weidemanis

Chief Executive Officer, Johnson Controls International Plc

Great. Thank you for that. And before I start with the closing remarks, it was great to reconnect with several of you over the last couple of weeks and on this call. I believe the partnership, the interaction, the questions you ask help make us better and think about things in a better way. So, thank you for that.

But to quickly recap, we're pleased with our strong second quarter results. Our record backlog and strengthened orders show broad-based demand for our differentiated solutions. And we have continued momentum underway. And now, with a more focused portfolio and simpler organizational model, and over time, stronger customer orientation and Lean-enabled execution, we're well-positioned to accelerate value for all of our customers and shareholders.

And I want to really thank our dedicated team around the world and to all of you for joining today's earnings call. I look forward to continuing the discussion over the next quarters. And with that, operator, that concludes our call.

Operator: The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.