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MANAGEMENT DISCUSSION SECTION

Operator: Hello, everyone, and welcome to the Johnson Controls Q3 2025 Earnings Conference Call. My name is Nadia and I'll be coordinating the call today. [Operator Instructions]

I will now hand the call over to Jim Lucas, Vice President, Investor Relations, to begin. Jim, 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 third 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. This morning, we announced strong third quarter results, continuing the momentum we've sustained throughout the year. Organic sales grew 6%, segment margins expanded 20 basis points to 17.6%, and adjusted EPS grew 11% and exceeded our guidance. Year-to-date, adjusted free cash flow has nearly doubled to $1.8 billion, and we are on track to deliver over 100% free cash flow conversion for the year.

Orders grew 2%, led by strength in the Americas and offset by ongoing softness in China. Our backlog grew 11% to $14.6 billion and remains at record levels. We continue to see strength in demand for both our Systems and Service solutions. We are now building an even stronger foundation for long-term success by developing a business system focused on simplifying operations, accelerating growth and scaling our impact. This includes sharpening our focus on what matters most to customers and deploying lean principles to tackle barriers to growth. We're raising our full-year guidance and Marc will give more details later in the call.

I now have my first quarter under my belt and tomorrow is my 140th day at a company celebrating 140 years of leadership. That is 140 years of winning with customers, driving innovation and supporting the advancement of human society with solutions for smart, productive, safe and sustainable buildings. Afterall, the advancement of science, education, healthcare and manufacturing occur in buildings. As we celebrate and reflect upon our history, we believe our best days are still ahead of us.

Unlocking our potential depends on placing even greater emphasis on the customer. Our goal is to deliver consistent predictable results over time and outperform our competition, enabling strong capital allocation and enhancing value for shareholders.

Since joining Johnson Controls, I've had the opportunity to travel the globe, visiting our largest factories and spending time in the field with our customers and teams. I have visited well over 100 customers, all of our major innovation centers, and walked more than 30 plants. I met with hundreds of our front line colleagues in sales, service, R&D and manufacturing. These travels produced insights that will inform our future success as a company.

First, we need to sharpen our focus on our customers while also staying ahead of the competition. Customer centricity will fuel accelerated growth by enabling us to win and retain customers more effectively through differentiated offerings and how we serve them.

Second, it's essential that we enhance our investment in R&D to accelerate innovation. Our IP portfolio is strong with 8,200 patents and more on the way. Our products and solutions deliver results that resonates with our customers. While we possess considerable strengths, there remain opportunities to accelerate growth within our core domains by addressing gaps in our product portfolio.

Third, our field position of 40,000 front line colleagues has been and continues to be a competitive advantage. We see clear opportunities to better equip and support them, making it easier for them to deliver for our customers. By doing so, we can get more leverage from our team and expand capacity and productivity to drive stronger results.

Given the importance of this effort, we recently appointed Chris Scalia as Executive Vice President and Chief Human Resources Officer. Chris brings a unique combination of people and culture strategy, operational excellence, and a deep commitment to building high-performing teams. We're excited for Chris to hit the ground running as we continue to transform Johnson Controls into a growth-focused, customer-centric powerhouse and a magnet for talent.

As we look ahead to our ongoing transformation, developing a business system and embedding it in our cultural foundation is a critical step in driving long-term success, one that requires dedicated effort, discipline, and patience. My deep experience with proven business systems, combined with spending meaningful time at Gemba, has helped us shape a clear vision for what this could look like at Johnson Controls. This business system is how we will win and run the company. It will be anchored in proven methodologies like 80/20 and Lean, and augmented by digitization and AI.

First, 80/20 is a powerful operating model that sharpens our focus, cutting through complexity so we can concentrate our energy on what matters most to our customers. We simplify. Then, adopting principles of Lean, we convert this focus into action with a strong orientation of what matters most to our customers. We eliminate waste, streamline workflows, and accelerate processes to drive speed and efficiency across the organization to better serve customers and increase our competitiveness. We accelerate. And throughout the process, we embed digitization and AI as core enablers in our process improvement. This augments our focus and speed with smarter systems and the ability to scale impact for our customers and our people. We scale. So, simplify, accelerate, scale.

While we made progress over the last several quarters, we know that with a strong business system in place, we can accelerate and improve our results over time. We will solve customer problems faster and more effectively by empowering our people. It will become our way of life at Johnson Controls. Our efforts are already underway. Since the last earnings call, we have identified a number of growth blockers and we are actively addressing them.

In general, the growth blockers center around the speed of execution and more effectively and efficiently leveraging our existing capabilities in the field and beyond. To ensure speed in decision-making and implementation, it is important to identify the root cause of these growth blockers and develop countermeasures that we can then implement into consistent repeatable processes. We have started with a narrow focus to deliver results quickly, and then we will scale more broadly.

I can give you two early examples of progress. The first example is in our conventional HVAC business, where we're creating value for our customers and our front line colleagues who serve them. Our objective is to substantially increase the amount of time our sales teams can dedicate to engaging with customers by streamlining internal processes and eliminating waste that does not contribute direct value to the customer experience. Over the last four weeks, this team has identified specific countermeasures to double time with customers for our sellers. This will unlock opportunities to better leverage our enviable field position.

Another focus area is improving lead times for our key chillers in North America, where we continue to see dynamic growth in the fast expanding data center vertical. We have an opportunity to cut lead times in half, which will both improve our competitiveness and create additional manufacturing capacity. As we deliver substantial improvements around the growth blockers we have identified, we can replicate these successes and deploy across our global portfolio.

With momentum building, our executive team has been trained on the core foundations of our future business system, and each of them have participated in at least one kaizen. After countless kaizens throughout my career, I participated in my first Johnson Controls kaizen a couple of weeks ago. Over the next few months, we will train our top 200 leaders and ensure their participation in kaizens and our program overall. As we begin to see tangible results from these early initiatives, we will expand engagement and training across the organization.

While we have many opportunities to drive growth through operational improvement and ultimately more consistent predictable results, we're also continuously evaluating and refining our strategy. This has started with a fresh objective view of all our business lines and solutions.

Looking ahead, we will evaluate our portfolio and make strategic decisions to ensure a sustainable growth through targeted acquisitions or thoughtful exits. As we move forward, our focus will progress to a comprehensive review of our operations, including our manufacturing and back office networks, to further unlock productivity and capacity.

In summary, we believe there are clear opportunities to optimize our portfolio, footprint, cost structure and the way we work going forward. This is an ongoing process with continued focus on delivering shareholder value. It has been a productive four months since I started at Johnson Controls. My excitement continues to build as we become more intensely focused on the customer, the people on the front lines who serve them every day and drive adoption of our future business system. I look forward to the journey ahead as we work together to deliver even greater value for our customers, team members, and shareholders.

With that, I will now turn it over to Marc.

Marc Vandiepenbeeck

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

Thanks, Joakim, and good morning, everyone. Turning to slide 6, we delivered strong result in the fiscal third quarter. While the broader environment remains uncertain, our execution continued to drive meaningful results. Our focus on operational efficiency is helping us to deliver for customers and reinforce our competitive edge. Our team is committed to generating consistent long-term value for shareholders.

In the quarter, organic revenue grew 6% and segment margin expanded 20 basis points to 17.6%. as we proactively mitigated the impact of tariff through strategic sourcing and cost management initiatives. Adjusted EPS of $1.05 was up 11% year-over-year, and exceeded the high end of our guidance range. On the balance sheet, we ended the third quarter with approximately $700 million in available cash. Compared to last year, net debt declined to 2.5 times, which is within our long-term target range of 2 to 2.5 times.

Year-to-date adjusted free cash flow improved approximately $900 million year-over-year to $1.8 billion. The strong performance driven by improved cash conversion reflects our disciplined financial management and consistent operational execution.

Let's now discuss our segment results in more details on slides 7 and 8. Orders in the quarter grew 2% as growth in Americas was muted by softness in China. Customer engagement remains strong, and we continue to see healthy activity across our pipeline. Additionally, the mix of orders is shifting toward higher margin solutions, reinforcing our long-term growth and profitability outlook.

Geographically, orders in Americas increased 5% with mid-single-digit growth in Systems. In EMEA, orders were up 2% against a tough comp, with 6% growth in Service offsetting a 1% decline in Systems. In APAC, orders were down 8% as a decline in system more than offset double-digit growth in Service. At an enterprise level, our organic sales growth was led by solid mid-single-digit growth in both System and Service.

Sales in Americas were up 7% organically, with continued strength in both HVAC and Controls. In EMEA, organic sales grew 4%, led by 8% growth in Service. In APAC, sales grew 6% organically, with strong double-digit growth from our resilient Service business. We continue to maintain healthy margin through disciplined cost management and strategic pricing, ensuring profitability even in a dynamic market environment.

Operationally, we have driven greater efficiency across our core processes, while improvement in our Service mix have allowed us to prioritize higher value offering that enhance customer satisfaction and support long-term profitable growth.

By region, EMEA adjusted segment EBITA margin expanded 100 basis points to 14.1%, driven by improved productivity and a positive mix of Service growth. In APAC, adjusted margins expanded 70 basis points to 19.4% as productivity continued to improve. In America, adjusted margin improved 10 basis points to 18.5% as system growth outpaced Service growth. Our backlog remains at record levels, growing 11% to $14.6 billion. System backlog grew 11% and Service backlog grew 8%.

Let's now discuss our fiscal fourth quarter and full year guidance on slide 9. As we enter the fourth quarter, we are building on strong momentum, driven by enhanced operational efficiencies and a backlog that remains at historical high levels. We anticipate organic sales growth of low-single digits, adjusted segment EBITA margin of approximately 18.6%, and adjusted EPS in the range of $1.14 to $1.17.

As a reminder, we have a challenging comparison due to a large onetime project we successfully executed last year. Based on strong execution and consistent performance, we are reaffirming our full year guidance for mid-single-digit organic sales growth and approximately 90 basis points of adjusted segment EBITA margin expansion. Additionally, we are raising our outlook for adjusted EPS and free cash flow conversion. We now expect adjusted EPS in the range of $3.65 to $3.68 per share, representing 14% to 15% growth.

Building on our strengthened working capital position, year-to-date free cash flow performance reflects solid execution and financial discipline. As a result, we now anticipate achieving free cash flow conversion of greater than 100% for the full year. We continue to target returning 100% of our free cash flow to shareholders through dividends and share repurchases.

Finally, we expect the sale of our Residential and Light Commercial HVAC business to Bosch to close in our fiscal fourth quarter. While we anticipate returning the majority of the net proceeds to our shareholders through share repurchases, the impact on this year's share count is expected to be minimal, with the benefit annually accruing in the next fiscal year.

Operator, we are now ready for questions.

QUESTION AND ANSWER SECTION

Operator. We will now begin the question-and-answer session. [Operator Instructions] We ask you please limit yourselves to one question and one follow-up. The first question goes to Amit Mehrotra of UBS. Amit, please go ahead.

Amit Mehrotra
Analyst, UBS Securities LLC

Q

Thanks. Good morning. Joakim, I guess, as you approach five months on the job, I know that's not a lot of time or a long time, but I guess it would just be helpful nonetheless to understand your initial observation. What are some of the KPIs you're focused on to kind of make sure the global organization is moving in the right direction? And importantly, how quickly you think we can see some of the tangible progress on the return profile of the business?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. Good morning, Amit. I hope you're doing well. Four months in, as you heard here in the prepared commentary, I visited a lot of places around the world, more than 100 customers, walked more than 30 plants and sat with colleagues in all of our innovation centers. And I think I've gotten a really good grasp of the opportunity here. And as you've heard me talk about before, number one is, we need to sharpen our focus on the customer at every level and every function of our company. And that's such a foundational point. And I'll come back to that.

And I also see opportunities to continue to drive growth through innovation, through increased investments in R&D. I'll come back to how we're going to fund that. And I see that we have really this enviable field position, 40,000 colleagues in the field, a capability that's been built over decades, difficult to replicate. But we have to find ways to unlock faster improvement in the company, improvement that is valued by customers and gives us room to continue to invest in, for example, innovation.

And that's why I spoke about a new business system that is information that we have started to deploy. And you heard a little bit about on the prepared remarks that that is anchored in 80/20, simplification and Lean, which is about acceleration. Speed, in many ways, is the ultimate competitive advantage. And augmented by digitization and AI to scale. So simplify, accelerate and scale. And the notion here is that speed is one of the largest competitive advantages.

And you can't, like, go too broad too quickly, so – because you also want to get the buy-in from your organization while you deliver value early. So we've started already and we're going deep. And as you heard, I gave two examples: one commercial example, which is more growth-oriented; and one operational example, which is both cost and growth-oriented. So the commercial example – and this is – these examples are examples, capabilities that we're building that we're going to deploy much broader over time. But you want to start narrow, so you can really understand the root causes of why we're not able to perform better. And so that you can go after the countermeasures and then build new processes and capabilities and then inspire other people in other parts of the company to do the same.

So the two examples were in our HVAC conventional business in North America. And one part of the country we have a team working on in their fourth kaizen now actually and where we have a path to basically doubling the selling time that our sellers have in that part of the business by improving – and removing waste from processes and improving the processes that we have. So that – I'm very excited about the potential of that more broadly over time.

And then on the operations side, I gave you an example of where we're working on cutting the lead time in half. And we're in our third kaizen on that one. I was in one of those kaizens myself actually the other week. And cutting lead time in half is – what you do to achieve that is basically the same things, similar things you would do to reduce cost and capital, tied up working capital that is. So, that effort will generate efforts beyond reducing lead time. And of course, reducing the lead time makes us more competitive. And in that case, the product lines we've started with are oriented towards the data center market where demand is still very high. And being able to deliver faster than others is an important part of our competitive advantage.

So anyway, so we're starting narrow, exciting the organization, training the organization. And then we're going to deploy those more widely over time. And we have lots of opportunities here on these kinds of themes. So I'm very excited about that.

Operator. Thank you. Moving on to the next question from Scott Davis of Melius Research. Scott, 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

Hey, Scott.

Scott Reed Davis
Analyst, Melius Research LLC

Q

And appreciate the color on that question. I'm kind of going to go a slightly different direction. You've had 140 days. Maybe that's not enough time to answer this perhaps. But are – do you have a better sense, Joakim, now of what the – how you can accelerate growth in Fire and Security and how that business really – how HVAC and Fire and Security can really lever off of each other? I think historically, it's always been a question mark of whether they fit or not. But I think investors at this point are pretty open minded on hearing your view.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. Yeah, thanks for that question, Scott. Yeah, these are – as we spoke about last time with all of you, I mean, I see – these are fundamentally different businesses serving a similar customer base, but different personas at different points in time. And so we're calling it as it is. That doesn't mean that they aren't businesses that don't have potential. They have potential as well. And many of the examples I gave on the new business system here are focused on HVAC and Controls, because we think that those markets inherently have higher levels of growth, but there's growth in Fire and Security as well.

And so the approaches that I described, we are gradually going to deploy into those businesses, and we think there's good potential to improve the performance there as well over time. And then like I said, we are taking a dispassionate view at the portfolio. And we are two-plus months into a deeper strategic review of our businesses where we're at today and looking at the future and who we would like to be, and we'll keep – and the board, of course, I'm working very closely with the board. And obviously these are not things you conclude in sort of one cycle, one board meeting. So, over the next couple of months, together with the board, we're going to start to draw conclusions on what the portfolio will look like here going forward.

Operator. Thank you. The next question goes to Jeff Sprague of Vertical Research Partners. Jeff, please go ahead.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Thank you. Good morning, everyone. Wondering if we could shift to free cash flow. Marc, nice to see the bump here this morning. Maybe could you address, and certainly, Joakim, would love your thoughts on this also, but where the most significant opportunities are on the free cash flow side? Should we view this 100%-plus sort of a catch-up on low-hanging fruit? Or is your confidence level that the company can kind of consistently be in that 100% ZIP code rising here.

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

A

For sure. Well, yeah, thanks for the comments. We had a strong start of the year in cash flow, and we've continued that momentum. I think the progress we've made this year has a lot to do with our accounts receivable, our collection management, and everything goes from managing order and managing customer through that experience. That has allowed us to really continuously improve the conversion throughout the year and has allowed us to get to that 100-plus-percent conversion.

Almost $1 billion of improvement year-on-year is a good feat, but it doesn't mean that we are done and that's all of the benefit we are going to see. We still have those fundamental structural headwinds we've talked about of our effective tax rate being slightly different than the cash tax rate, and we still have slightly elevated CapEx, but those two things over time will die down.

There's a lot of opportunities that are going to come from our Lean efforts and Lean transformation. And I think if you think about when we start that flywheel around that Lean transformation, the need for facilities will reduce over time, which will reduce CapEx, which will reduce inventory.

Our ability to increase cycle time and improve customer centricity will also drive ultimately better outputs from an inventory standpoint. And we think that's where, moving forward, the larger opportunity is, but there's still progress to be made on every aspect of the fundamental of our free cash flow conversion.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. I mean, I'll second that. And the lead time reduction example I gave, I mean, in principle, that means that we'll be able to get a lot more output from that facility without adding additional physical asset space. And so, that means that we're going to sort of decouple versus historical trends the CapEx that we need for our growth. So that's really what that is about. And we're also going to, by the same token, because with the approaches we're applying there, decouple the addition of inventory dollars for the growth dollars that we have. So that's really what that lead time reduction initiative is about. And like I said, we've started narrow, and we'll go broader over time.

But then on the commercial side as well, we have a work stream. I think we're in our second kaizen now, where we're looking at how we're performing on billing and how fast do we bill, how accurate is our billing and, therefore, how – what is sort of the first pass yield on customers paying invoices. Every company – no company in this world is perfect on invoicing, right? There's – sometimes you miss a few. And if you have a couple of percent of invoicing errors that you need to redo versus less than 1%, that not only impacts customer satisfaction, but of course, also your cash flow. So we've seen some good opportunities in that area, too.

So those themes give me confidence that we're going to be able to maintain the cash conversion that we've seen so far this year.

Operator. The next question goes to Nigel Coe of Wolfe Research. Nigel, please go ahead.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning. Just want to follow up on that last point. I mean, I don't want to sound greedy, but with the intangible amortization, is there a pathway to maybe being above 100% free cash conversion based on the current reporting structure?

And then maybe if we could maybe go back to the portfolio, very clear messaging there. Are we still in the zone of 5% to 10% of the current portfolio being, I guess, with a question mark over its strategic importance?

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

A

Yeah, Nigel. I understand the question on above the 100%. I think it's a little early for us to commit. What I can tell you is that, historically, we've said the algorithm was 85%, 90-plus percent. I think we are comfortable that we'll be able to deliver solidly in the 90s in terms of conversion. And over time, as we see the improvement on the Lean transformation yielding the results, we could raise from there. But at this stage, it's a little bit too early.

On the portfolio, I would say the immediate actions we are taking on some of the assets that we believe are noncore, it's still within that 10%, 15% range. Now there's a broader amount of work that's being done, Joakim alluded to that earlier. And that could be greater than the 10% over time as we validate kind of our strategic vision with the board and kind of decide where we can focus and orient the company to be successful and grow faster.

Operator. The next question goes to Steve Tusa of JPMorgan. Steve, 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

Can you maybe just – the order number at low-single digit was maybe a little bit lighter than I was expecting. How do you guys feel about that trending into the fourth quarter? And then secondarily, what's the time line for when you guys provide perhaps a bit more of a longer-term outlook around what all this action is going to turn into financially?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Very good. Yes. So orders in Americas was strong. EMEA, in my view, was better than perhaps what the number appears to be because of the compare. And then, clearly, there's ongoing softness in China. And so, as you would expect, we continue to dig deep into leading indicators, our pipelines and so on. And my conclusion is that our core vertical markets, they remain healthy. And it's not just our health care verticals and our data center verticals. But, overall, there's no change. So I feel good about our pipelines.

And then on China, which we've talked about before as bouncing around the bottom, I guess, we've called it, our – we continue to be very disciplined there around going after higher-margin systems orders and then prioritizing our Service business there. And so we had healthy growth on the Service side. And China is maybe a longer discussion, but I was there recently and maybe the one tidbit is that that market is gradually turning into a more mature market in the sense of that the retrofit part of the market is – continues to steadily increase, which is different than a number of years ago when it was sort of a new construction new build market. So it's starting to look a little bit more like some of our Western markets.

But near term, short term, yes, new builds in China, as has been talked about by many players, is a challenging space to be. So we need to be very diligent about what we choose to go after there and protect and manage our margins.

Operator. The next question goes to Joe Ritchie of Goldman Sachs. Joe, please go ahead.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good morning, guys.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Good morning.

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

A

Good morning.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

So with – yeah. So with the quarter ending with record backlog, Joakim, I'm curious whether there's a way for you to maybe just give us an initial framework for 2026. And then maybe just going back to Steve's question on the long-term targets, just wondering whether you're planning an Investor Day next year as well.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So I appreciate – Steve, I apologize, we didn't answer your question. So I will make a note of making sure that we do that next time. We are working on 2026 as we speak. I'm 140 days in. So, of course, I want to make sure I do a really detailed job together with Marc there.

So – but maybe, Marc, you could share a few words on where we're at.

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

A

Yeah. And we are on the finalization of our internal plan for 2026. So it's a bit early for us to comment on this. But I think, overall, the long-term algorithm we've been talking about with, as a reminder, mid-single-digit top line growth, looking for well over 25% incrementals and then double-digit EPS growth, remain the basis for now.

But as we implement the new business system, as we continue to do our strategic review, it's hard to imagine not having better incrementals, for example, over time, and understanding how that will influence the ultimate long-term algorithm. I think we'll be better positioned to give you a view on that as we close the year, release the fourth quarter and start talking guidance for 2026 and give you a better view.

As far as Investor Day, we really want to go through that deep understanding of our strategic orientation before we take people deeper into what the new JCI may look like and what it would mean long term from an investment thesis. So, give us a little bit of time there to get through that and sharpen our pencil on the strategic view.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. And on the guide, what I – the two examples I've mentioned that we're working on as vehicles to implement our new business system, just to reinforce what Marc said, we're – the commercial example I gave you with increasing the amount of selling time available for our sellers, that's really about decoupling the needed investment in field personnel to drive growth, decouple versus how we've – that algorithm has worked in the past. And then the operations example I gave is really about decoupling both CapEx, inventory and cost, quite frankly, to also drive the kind of growth that we aspire to here from the cost.

Operator. The next question goes to Nicole DeBlase of Deutsche Bank. Nicole, please go ahead.

Nicole DeBlase Q
Analyst, Deutsche Bank Securities, Inc.

Yeah. Thanks. Good morning, guys.

Joakim Weidemanis A
Chief Executive Officer, Johnson Controls International Plc

Good morning, Nicole.

Nicole DeBlase Q
Analyst, Deutsche Bank Securities, Inc.

Just wanted to ask something – hello. Just wanted to ask something a bit short term in nature. I think, typically, if we look at EPS seasonality throughout the year, you've historically tended to see like a low-teens percentage increase in 4Q relative to 3Q. The guidance this year implies something a bit lower than that. So just want to understand, Marc, if you could kind of help with any major puts and takes between 3Q and 4Q that we should be considering. Thank you.

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

Yeah. Nothing in particular. There's two kind of dynamics that are happening at the same time. There's a bit of uncertainty on what tariff will do on the bottom line. So far, we've executed very well, but we've taken some conservative view into the fourth quarter.

And then you got to remember, with the extraction of our Residential and Light Commercial business, which was more transactional shorter-cycle business, we are now a little bit of a longer cycle company. And therefore, the variation you see quarter-over-quarter is a little bit less seasonal.

Now transparently, the fourth quarter, particularly in our HVAC and Controls business, is very healthy quarter generally from a growth and, therefore, absorption of our field team simply because of the weather in the Northern Hemisphere. And so it will naturally provide better tailwinds overall, but nothing vastly different if you look at the enterprise from a continued basis standpoint.

Operator: The next question goes to Joe O'Dea of Wells Fargo. Joe, please go ahead.

Joseph O'Dea Q
Analyst, Wells Fargo Securities LLC

Hey. Good morning.

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

A

Hey, Joe.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Marc, in reference to your comment around the – hi. Just the comment around the algorithm and well over 25% incrementals, can you touch on restructuring and the program that was announced last fall? Of the $500 million, what savings you anticipate achieving this year, just kind of broad strokes what the setup would be for what you can achieve next year?

And then separately and with some of the legislative developments, just anything on tax. I think you've previously outlined that that could be up 400, 500 bps year-over-year as we go into next year, but not sure of any recent developments there.

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

A

No. So on restructuring, Joe, so $400 million of restructuring costs, we've probably spent just a little over that. And we think we've gotten probably dollar-for-dollar restructuring saving. That's really part of the margin improvement story as we eliminate a lot of the stranded cost associated with the Residential and Light Commercial sale throughout the year even before the close on the transaction. And so we believe we are going to continue to drive towards that $400 million to get the full run rate [ph] $500 million (00:40:10) benefit at the exit of 2026.

I can tell you that the early efforts around our Lean journey and transformation, we will probably have to think about how we position the restructuring – the balance of the restructuring program and if we should further extend it and potentially gain even more benefit from a return on those restructuring efforts.

From a tax standpoint, there are some small changes at the fringe that will require kind of differentiated planning on our side. But net-net, the rate headwind I've been talking about of 400 to 500 basis points on a, as a reminder, 12% base effective tax rate in 2025 will remain in force. It's really around that global minimum tax and how that drives the pressure on the rate.

If you recall, the interesting component there is that from a cash tax rate, it doesn't materially change the math for 2026, which is, by the way, a little bit of a tailwind from a free cash flow conversion as our cash tax rate will remain in the low-20s, high-teens potentially, depending on different action we take.

Operator: The next question goes to Andrew Obin of Bank of America. Andrew, 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.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Hey. Just a question going back to Americas orders. Could you by any chance disaggregate the orders between Fire and Security, Commercial HVAC? And specifically, what are you seeing on data centers? Because you have such a strong market share globally in the market. And given the overall strength, I would echo the sentiment, I would have expected a little bit more growth. But maybe just give us a sense what's happening. Are there any specific push-outs, but by verticals, thank you, in Americas?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Yes. Thanks, Andrew. Data centers continues to be very healthy, and it's about 10% of our sales today, growing very nicely. And there's, of course, a reason why we decided to deploy the initial stages of our business system focused on the operations, manufacturing side of things to help cut lead times for a data center product line. So we see that continuing here over time. We're doing well with both hyperscalers and colos. And perhaps, we can have a more detailed discussion at another point in time. So that's that side of the business.

The HVAC and Applied side of our business, in general, is doing very well. And the example I gave on Commercial, where we're deploying the business system, is in HVAC and Applied outside of data centers. And so we're already growing at a very healthy rate there. And Fire and Security is – we're growing, but at a lower rate than HVAC. That's more in low-single digits. We see – those are shorter-cycle businesses, by the way, as well, I think you know that. We see plenty of opportunity to apply the principles of what we're doing on the HVAC sales side in those businesses as well. But we chose to start in HVAC because, in short term, we just think there's a bigger opportunity there.

But – so Applied HVAC and data center heavy is the story here. But those other businesses are still growing at – are still growing, but low-single digits.

Operator. The next question goes to Chris Snyder of Morgan Stanley. Chris, please go ahead.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC
Q

Thank you.

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

Hey, Chris.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC
Q

If we look at JCI Service business, it's had really good top line growth over the long term. But if we look back at history, is there any color you could kind of talk about or provide as to how margins have expanded or the business has kind of driven operating leverage over the last few to several years?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

I think the answer to that is not enough operating leverage, and that is now an opportunity for us. And I think there are, from my travels, two reasons for that. I think just like we – the example I gave on the HVAC sales, by applying Lean principles, we're able to remove waste in our internal processes and help accelerate the sales process just in general.

I think we have the same opportunity in Service, so that we can gradually break the back off of the connection between Service growth and adding Service cost. So I see good opportunity in that. That's a body of work that we're going to be launching over the next quarter here. So there's an operational side to the story.

And then I think in a couple of our businesses, the way we productize Services, I think there is an opportunity to add more differentiated Service products to our portfolio. And perhaps, I can come back to that at some point in time in the future. But when I spoke about – in the prepared commentary about wanting to increase investments in innovation, I'm not only talking about investments in Systems, but also in Service products.

And some Service products might require some – a few tweaks and changes and additions to our Systems on the installed base as well as new products, but there's also innovation opportunities on, for example, how you digitize services to be able to deliver, if I could call them, more outcome-oriented Service products to customers versus more sort of break-fix oriented Services.

So I see good opportunities, both operationally as well as from a product and differentiation point of view and being able to both continue the Service growth and then, like I said, break the back off of the growth and the costs, so that the margin can improve over time.

Operator: The next question goes to Julian Mitchell of Barclays. Julian, please go ahead.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Hi. Good morning.

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

Hi, Julian.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Thanks very much. Just wanted – hey. Just wanted to ask about sort of operating margins and a couple of different questions on it. I think, first off, the OE mix is fairly muted year-on-year in the second half of this fiscal year. I understand tariffs are weighing. But is the sort of construct that that – or those related headwinds last sort of through the first half of next fiscal year and then you get a larger sort of jump in the back half on margins as that tariff headwind eases?

And sort of beyond the next 12 months, I guess I was intrigued, Joakim, about – you sound sort of relatively muted on the margin potential in Fire and Security, perhaps the growth outlook as well. And I just wondered if that's around JCI's positioning, something around market share because, certainly, there are some peers out there like Honeywell or Allegion, say, this past quarter or two, who are putting up pretty decent numbers in various parts of F&S. Thank you.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. Thanks. Well, I'll let Marc take the first half of the question...

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

A

Right.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

...and then I'll add on.

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

A

Yeah. So on the OE mix, you're right, part of it on the rate standpoint is clearly the tariff, where we've been able to recover the vast majority of that headwind, not always being able to consistently drive margin on that recovery. Some markets, we have more pricing power and we have been able to recover with margins. Some other markets, given the size of the tariff impact, it was a little bit more difficult to justify to the end customer that we have to receive margin on that.

And then you got to remember, there's a lot of stranded costs in our SG&A associated with the continued-discontinued operation, the Residential, Light Commercial. There is a lot of work underway and progress being made to actually take that cost out. But that's muted a little bit our ability to expand margin beyond the expectation. But I think, moving forward, we have opportunity.

I'll pass it on to Joakim on the Fire and Security margin opportunity.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Yeah. Yeah, so on – if we start with fire, and since you mentioned Honeywell, they've done, I think from what I understand, a very nice job on the product portfolio over many, many years. So when I talked about us having some product gaps in our portfolio, I was thinking about fire detection as one example. So we play a little bit more on, let's call it, the premium or the more sophisticated system side of the market. We have some opportunities to go beyond that over time.

And on the security side, it's a market that consists of many, many different kinds of solutions. So you need to be careful with the apples-to-apples or apples versus oranges. You may recall that I used to be on the board of ASSA ABLOY, Allegion's biggest competitor, right? So I've seen that from many different angles. So on the security side, like fire detection, yeah, there are some product gaps that we have opportunities around.

Now on the Service side of things, to talk about margins, as I mentioned here previously, I think there's good opportunities to do work to, again, break the back off of the Service growth and the Service margins based on applying Lean principles and how we operate in the field on sort of providing the services. And I also think there are some opportunities in productization of services that could drive greater differentiation. So I see those opportunities.

Now, again, I – we do see that the opportunity in HVAC and Controls as being one of having higher growth over time and probably a little bit of a higher margin opportunity over time as well. It doesn't mean the other two are bad businesses. I think we can operate those better over time versus how we have in the past. And like I said, we're working our way at the strategic review of the portfolio diligently, thoughtfully. And once we have a conclusion, we will certainly let you know.

Operator: The next question goes to Andy Kaplowitz of Citigroup. Andy, 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

Hey, Andy.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc A

Hey, Andy.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc. Q

Just wanted to follow up on that line of conversation a little bit. You've had recently strong margin improvement, I think, in your other segments outside of the Americas. So as we think about the Americas going into 2026, obviously, you have a mix component. We've talked about tariffs, and you just talked about Service.

Can you improve the margin there as you go into 2026? Is there anything in the competitive environment that may be holding you back? Because I know you've shown good improvement in Europe pretty quickly. So can you do that in the Americas as well?

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc A

Yeah. Maybe I can start with a little bit of a long-term view that we've discussed a little bit more on our previous caller a quarter ago. So based on – and I still have the same view as when we spoke last, which is I really see no reason for why, from a margin point of view, we should be below our direct competitors over time. It's not a one-year thing. It's not a five-year thing, either. And I think over time, we can aspire beyond that.

And how do we get there? I mean, I gave you some examples today in the prepared remarks of how we're going to apply – deploy a business system to do that. Both – I gave you a commercial example and an operational example. And the two I gave were – happened to be North America-oriented examples, but they will – over time, we will deploy that in other regions as well. So, yes, I believe we have continued opportunity in all regions on margins.

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

A

Yeah. And in the short term, Andy, you have system that continues to update service. And so that – our Service business being overall a higher margin business, that will taper a little bit the mix headwind you were talking about. This quarter, we had year-on-year M&A headwind about 20 basis points that didn't help. But from a growth in productivity, if you exclude tariff, we had solid improvement in that margin line. And so I think it's more muted in the short term. And as we get through those tariff changes and we get the M&A behind us, and the mix balances out to a more balanced 50-50 between Service and System, I think in addition to the opportunity, you have some tailwind here in the Americas from a margin standpoint.

Operator: The next question goes to Deane Dray of RBC Capital Markets. Deane, please go ahead.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning, everyone.

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

A

Hey, Deane.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

A

Good morning, Deane.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Hey. I was – wanted to circle back on free cash flow, if we could. And it really wasn't very long ago where JCI was struggling at that 80% conversion with kind of tempered expectations on where and how it would be improved. And it really does feel like you've turned a corner here. Just can you give us a sense of the sustainability above to be in and around 100%? And just remind me, did the sale of Resi provide any kind of structural lift to the cash conversion cycle?

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

A

Let me start with that last one. Resi was actually a headwind. It was a higher cash flow converter because of the JV structure we had within that business. So, that put about 5% to 10% headwind to our overall enterprise conversion.

In terms of sustainability, and to kind of give you a sense of the two different, we've fundamentally changed a lot of processes internally, how we bill, how we onboard supplier, how we manage our inventory. And we've been a little bit more maniacal around where we deploy CapEx and the pace at which we deploy those capital expenditure. And you combine all of that together, it provides a solid foundation to at least perform in the 90s or 95-plus, I would say, from a free cash flow conversion.

I don't think any of those fundamental are at a risk of going backward. Quite the opposite. As we are in a process of improving, they provide short-term tailwind, and I'm very confident that we are going to be able to hit that 95-

plus percentage. And then over time, as we progress on Lean, as I mentioned earlier, on the Lean transformation, that flywheel start providing additional tailwind, I think we'll be more comfortable talking about 100% or 100%-plus. But at this stage, I'll stick to 95%.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc
A

Yeah, and we're early in the journey on inventory improvement. So, over time, we're going to go make some progress there.

Operator: This concludes our Q&A session. I would now hand the call back over to Joakim Weidemanis for any closing comments.

Joakim Weidemanis
Chief Executive Officer, Johnson Controls International Plc

Well, thank you all for your questions. We have an exciting future ahead of us here at Johnson Controls. We have a lot of work underway, as you heard, and many opportunities to unlock. With a culture centered around our growth business system, I'm confident that our increased focus on our customers will allow us to continue to win with them.

I'd like to take a moment to thank our 100,000 team members around the world. You are the foundation of our company, and I'm confident for what the future has in store. I look forward to continuing my conversations with all of our stakeholders. Thank you. Thank you, all.

Operator: This now concludes today's call. Thank you all for joining. You may now disconnect your lines.