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Johnson Controls International Plc (JCI)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Johnson Controls Fourth Quarter 2024 Earnings Conference Call. Today, all participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note that today's event is being recorded.

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

Jim C. Lucas

Vice President-Investor Relations, Johnson Controls International Plc

Good morning and thank you for joining our conference call to discuss Johnson Controls' fiscal fourth quarter 2024 results. The press release and related tables that were issued earlier this morning as well as the conference call slide presentation can be found on the Investor Relations portion of our website at johnsoncontrols.com.

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

Before we begin, let me remind you that during our presentation today, we will make forward-looking statements. Actual results may differ materially from those indicated by forward-looking statements due to a variety of risks and uncertainties. Please refer to our SEC filings for a detailed discussion of these risks and uncertainties in addition to the inherent limitations of such forward-looking statements.

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

I will now turn the call over to George.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Thanks, Jim, and good morning, everyone. Thank you for joining us on the call today. I would like to start today's call by taking a moment to acknowledge and thank all of our employees for their contributions in delivering strong quarterly results. We also made significant progress in our transformation to simplify our portfolio and become a pure-play provider of comprehensive solutions for commercial buildings. Today, we are a faster growing, more profitable, simpler company.

Let's begin with slide 4. We ended fiscal 2024 with momentum, delivering double-digit organic revenue growth, robust margin expansion and 96% adjusted free cash flow conversion. Order growth of 7% in the year was led by data center demand and contributed to our record backlog, which ended the year at $13.1 billion.

Our differentiated solutions to enhance efficiency and sustainability in commercial buildings continue to resonate with our customers across the key verticals we serve. For example, we extended our leading position in cooling for data centers with orders for the full year more than doubling the sales we delivered. In fact, we are now seeing key customers placing multiyear orders in the hundreds of millions of dollars to provide cooling solutions.

Our pending sale of the Residential & Light Commercial business to Bosch is progressing and we expect the transaction to close in the fiscal fourth quarter. Today, we are introducing our fiscal 2025 guidance from continuing operations of $3.40 to $3.50, which Marc will give more details on later in the call.

We believe we are well positioned going forward to deliver long-term shareholder value. Our business transformation is almost complete and we are benefiting from more consistent, predictable performance.

Slide 5 presents a pro forma look at the new Johnson Controls, representing the composition of our company going forward. Today, Johnson Controls is a leader in building solutions dedicated to solving our customers' needs for energy efficiency and clean electrification. Our innovative approach and commitment to sustainability are driving us forward, ensuring we provide cutting-edge solutions that meet the evolving demands of the market.

Johnson Controls' unique customer value proposition directly translates to shareholder value creation. Our multi-domain presence enables us to serve our customers over the building lifecycle while also delivering safe, healthy and sustainable solutions. This means we can meet the needs of our customers all over the world and deliver cost savings and efficiencies for them.

We are confident we are well positioned with the integrated domain expertise and an extensive branch network to deliver greater value to our customers. In turn, we believe this will lead to a sustained top line growth and significant margin expansion.

As part of our path towards simplification, we have now deployed one end-to-end operating model that we leverage globally across all of our key verticals. This is positioning us with a unique capability in serving buildings and leveraging our digital expertise to expand our connected services model.

We are improving productivity on behalf of our customers, helping them maximize outcomes for their buildings. Whether it is the fast-growing data centers, expansion of campus housing and labs in higher education, or solving needs across healthcare from hospitals to outpatient facilities, we deliver our engineered solutions across all of our key verticals. This enables us to realize the benefits of this model over the lifecycle of our solutions, ensuring sustained value creation.

Johnson Controls is better positioned than ever before to help customers create safer, more sustainable buildings, while also maximizing the occupant experience. Our strong finish to fiscal 2024, coupled with our record backlog, reinforces our confidence that Johnson Controls will continue to lead globally in building solutions.

With that, I'll turn it over to Marc.

Marc Vandiepenbeeck

Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

Thanks, George, and good morning, everyone. Please turn to slide 6. Our performance in the fourth quarter highlights continued strong execution across the portfolio. Our single end-to-end operating model provides the visibility needed to drive consistent and predictable results. This was evident in our performance in the quarter as organic revenue grew 10% and segment margin expanded a robust 260 basis points to 18.6%, led by substantial improvement in both EMEA/LA and Global Products.

We delivered another strong quarter of increased productivity while converting our higher margin backlog. Adjusted EPS of $1.28 was up 22% year-over-year and exceeded the high end of our guidance range by $0.02.

Our operational efficiency contributed to the majority of the growth and more than offsets additional corporate expenditure primarily related to IT investments.

The strategic allocation of resource ensures we are well equipped to support our growth and safeguard our infrastructure. Below the line, net finance charges were higher, while EPS benefited from a lower share count. Overall, we achieved significant EPS growth and we are pleased with these results.

On the balance sheet, we ended the first quarter with approximately $600 million in available cash and net debt decreased to 2 times, which is the lower end of our long-term target of 2 to 2.5 times. Our adjusted free cash flow conversion of 96% was a strong improvement year-over-year and substantially exceeded our previous commitments. This trend is reflecting our improved fundamental in working capital management.

Adjusted free cash flow of $2.4 billion improved nearly $800 million year-over-year. For the full year, we returned $2.2 billion to shareholders via dividends and share repurchases.

Let's now discuss our segment result in more details on slides 7 through 9. Beginning on slide 7, our Global Product business had a strong finish to the year. Organic sales grew 8% as price remained positive and we delivered 5 points of volume growth. Low double-digit growth in HVAC, both commercial and residential, offset declines in fire and security and industrial refrigeration.

Strength was broad-based across the region, led by double-digit growth in North America. Adjusted segment EBITA margin expanded impressive 700 basis points to 28%. We have made tremendous progress over the past year in improving our operational efficiencies, leading to substantial margin improvement experienced in fiscal second half.

Turning to slide 8 and 9 to discuss our Building Solutions performance. Building Solutions delivered a solid performance this quarter, underpinned by sustained order momentum, double-digit revenue growth and margin expansion.

Additionally, we increased our record backlog, which remains at historical levels and underscore the strength of our business model. Our outcome-driven solution offering continue to resonate with our customer across many of the attractive vertical we serve.

With strong growth in data center, government, healthcare and higher-ed, orders grew 8% in the quarter, led by mid-teen service growth while system order grew 5%, again a tough double-digit comparison. Orders in North America increased 7% in the quarter with low-teen growth in service, led by strength in fire and security. System orders grew 3% against the tough comp.

In EMEA/LA, orders were up 14% with over 20% growth in service, while system order grew 9%. Across the portfolio, we saw strong double-digit growth in HVAC controls and industrial refrigeration.

In Asia Pacific, momentum is building as orders rebounded from the past few quarters of decline. Overall, orders grew 6%, led by 9% growth in service. Our pipeline of opportunities within Building Solutions remain healthy as we continue to build on the momentum of the past several quarters.

Our Building Solutions segment entered the quarter with a record backlog, which provided a solid foundation enabling us to capitalize on high demand for solutions and services. Organic sales increased 11%, led by double-digit growth across both systems and service.

Our sustained service growth sets us apart as we continue to deliver differentiated lifecycle solution for our customers. Sales in North America were up 16% organically with continued strength across HVAC and controls. In EMEA/LA, organic sales grew 10% with double-digit growth in controls, security and industrial refrigeration.

In Asia Pacific, while sales declined 5%, we saw sequential improvements. This improvement was driven by a stronger backlog in our resilient service business.

The margin profile within our Building Solutions segment continues to strengthen due to the enhanced productivity, favorable service mix and the improved operational efficiencies while executing our higher margin backlog. By region, EMEA/LA adjusted segment EBITA margin expanded 370 basis points to 11.5%, driven by improved productivity and the positive mix from growth in service.

In APAC, adjusted margin expanded 70 basis points to 14.2% as positive mix from our service business offset a decline in systems business. In North America, adjusted segment margin declined 40 basis points to 15% related to mix as systems grew faster than service.

Building Solution backlog remained at record level, growing 7% to $13.1 billion. Service backlog grew 12% and system backlog grew 6% year-over-year.

Let's discuss our first quarter and fiscal 2025 guidance and the impact of discontinued operation on slide 10 and 11. We are entering fiscal 2025 with momentum and our record backlog offers great visibility into the new year.

Our service business remains well positioned and provides a favorable mix to margins. As we look to our guidance for fiscal 2025, we will be presenting both the first quarter and the full year on a continuing operations basis.

After moving the Residential & Light Commercial business to discontinued operation, our fiscal 2024 continuing operation adjusted EPS is $3.21 per share. For the first quarter, we anticipate organic sales growth of mid-single digits, adjusted seg EBITA margin expansion of over 100 basis points to approximately 14.5% and adjusted EPS in the range of $0.57 to $0.60, representing 24% to 30% growth.

While the first quarter is against an easy comparison, the overall fundamentals are strong entering the year. For the full year, we expect organic sales growth of mid-single digits, which is consistent with our long-term growth algorithm. Adjusted seg EBITA margin are expected to expand over 50 basis points. Our adjusted EPS range of $3.40 to $3.50 per share represent 6% to 9% growth.

We expect free cash flow conversion of 85% or greater, consistent with the performance of fiscal 2024 on a continuing operations basis. We continue to target returning 100% of our free cash flow to shareholders through dividend and share purchases.

We expect the Residential & Light Commercial divestiture to close during the fiscal fourth quarter. Consequently, we have not included any capital deployment from sales proceed in our fiscal 2025 outlook.

Additionally, we are committing to a multiyear restructuring plan to address stranded costs and further right-size our global operations, following our previously announced portfolio simplification actions. We anticipate incurring roughly $400 million in expenses over the next three years, resulting in expected annual cost savings of approximately $500 million.

Similar to the timing of deploying capital from the closure of the Residential & Light Commercial divestiture, many aspects of this restructuring plan will depend on the timing of the close of the transaction. We are confident this factor will drive sustained success and create long-term value to our stakeholders.

While fiscal 2024 was a year of significant portfolio transformation, we are better positioned as a faster growing, more profitable, simplified company. We look forward to updating you on our progress as we continue our strong momentum entering fiscal year 2025.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session [Operator Instructions] And today's first question comes from Nigel Coe with Wolfe Research. Please proceed.

And Mr. Coe, your line is open. You may ask your question.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Oh, good morning. Sorry. I had the mute button there. Thanks for the question. So the – I think, Marc, this is a question for you, the mid-single digits, how do you see that across the segments? I'm assuming APAC probably is a bit above that. So just curious how you see mid-single digits across the segments and any color on the 50 bps, again, across the segments.

And I just want to verify, obviously, the restatements are happening within Global Products and it looks like the clean EBITA margins in 2023, 2024 were 25.7% and 27.1%, ex-Hitachi and YORK. So just want to make sure those are the right numbers.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Yeah. Good morning, Nigel. A lot to cover there. So first on growth, we had a very strong growth quarter and very happy with the results, but we're entering the new year with a record backlog of about $13.1 billion. And I think we continue to target that mid-single digit. Granted, we have a lot of confidence given the level of backlog we have. As you know, the timing on some of the larger project can impact quarter-over-quarter growth rate and I think we are seeing some very strong tailwind in the core vertical.

Now, if you think by segment, how that growth rate in mid-single-digit is going to break down, we think APAC is going to be slightly above that overall guide for the enterprise, really on an easier compare, and as we showed in the fourth quarter, we're starting to see sequential order growth for that business. And the rest of the businesses, North America, EMEA/LA or Global Product, will be at or just slightly below that overall guide throughout the year.

Now, when it comes to margin, and I hear you both on the total margin and the continued operation basis Global Product margin, what we covered in the last quarter when we gave guidance for Q4 is with the base cost and how we dealt with that base cost within that business, and a lot of the disruption from a supply chain standpoint being behind us, a little bit of volume was going to go a long way and you saw that in Q4. And I think that's going to remain through as we enter fiscal year 2025.

We've been driving significant operational efficiency that are structural and fundamental across both the manufacturing base and the supply chain. And you can see that that Global Product business has benefited and we continue to see benefit from an improved absorption, and that leverage will continue to provide easier comps year-on-year.

Now that business has some seasonality to it, so the first part of the year will be a little bit softer than the second part of the year, but that margin we feel is very well set for fiscal year 2025.

Nigel Coe
Analyst, Wolfe Research LLC
Q

And just want to make sure I've got [indiscernible] (00:18:52) for the Global Products margins in fiscal 2023, 2024, so any help there would be good. But I'm just wondering, George, maybe if you could comment on the CEO succession. What progress has been made identifying the right person to replace you when you retire?

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

Yeah. Good morning, Nigel. We understand there is significant interest in ongoing CEO succession process. At this time, we don't have any new updates to share, but you can be rest assured that the board is actively considering an impressive list of candidates, both internal and external. And we do expect to have an update in the first half of calendar 2025.

Operator: And today's next question comes from Steve Tusa with JPMorgan. Please proceed.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Yeah. Hi. Good morning.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

Morning, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Sorry, just wanted to better understand that, the first quarter. I'm not quite sure if the guide you just gave was for the year or the first quarter. But, I mean, with orders trending up 8% with your organic being so strong this quarter and the comp not looking particularly hard, what is the reason why first quarter is only up mid-singles in organic, specifically?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

Yeah. So if you think about the timing of some of those larger orders and how their revenue, particularly the big verticals that we are benefiting from, whether it's large decarbonization projects or the data center project, we had very strong performance in the fourth quarter in those particular vertical. And that quarter being the busiest season for our services business, we also had very strong performance there with double digit service growth. While that's probably sustainable over the long-term, there's some quarter-to-quarter volatility to that. And so a mid-single-digit growth for Q1, granted on an easier compare versus last year, is where we feel comfortable, really coming from [ph] two (00:21:04) places here.

North America, we'll see some strong performance, probably a little bit higher than that mid-single-digit, but both EMEA/LA and APAC as well as Global Product will be right in line with that mid-single-digit or slightly lower. And I think that's where we feel comfortable where the growth is going to come next quarter.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. And then, can we just get for the refresh portfolio what percentage of revenue now is data center that you expect in 2025?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Consistent with what we said prior, give or take a little bit, our data center exposure is about 10% of our revenue and continues to grow faster than the rest of the portfolio with very solid double-digit growth sequentially at least for the foreseeable future.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. And then...

Operator: Our next question comes from Scott Davis with Melius Research. Please proceed.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Hey. Good morning, George and Marc and Jim.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Good morning, Scott.

Scott Reed Davis
Analyst, Melius Research LLC

Q

So I – when you get a big data center order and you do an install, does it typically come with a similar kind of attachment, service attachment rate and OpenBlue that you would have in the building, or is it – is there a different kind of attachment rate there?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Yeah, a very good question, Scott. The service overall is slightly better than our portfolio from an attach rate standpoint. The digital services really depends on the type of customer. That particular vertical is very sensitive to digital solution and is very cautious about how they deploy it. There are some customer that have a little bit more cutting edge than other expecting to have full connection. Some others would like to manage that on their own. But the service attach rate for that business is very, very strong and better than the rest of the portfolio.

And it's changed a lot, I'll tell you, over the last probably five or six years where that vertical probably five or six years ago was not very high service attached, where a lot of those key customers had taken the view that they wanted to self-serve some of that. I think what they've learned with the complexity and also the quality of our capabilities, we are really able to differentiate ourselves and provide a full suite of service with guaranteed outcomes for those customers.

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

And Scott, what I would tell you, the short-term, the trend is significantly up because as you look at these data center sites, we have hundreds of units deployed on these sites and we have dozens of our technicians that are supporting these operations. And we've made the case that when we have connectivity, number one is not only are we more efficient in how we serve them, but we can be very proactive in making sure we're maintaining the overall operation. So the trend is actually significantly up because of that.

Scott Reed Davis
Analyst, Melius Research LLC
Q

That's helpful, guys. And just now that you've had another quarter of seeing big orders come through and such, how would you compare kind of the pricing power in that vertical to the traditional building segment? Is it a little bit better because it's more complex or is it more comparable because, honestly, everything in applied isn't that easy?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

Well, there's some part of applied that are slightly commoditized, but most of applied is engineered solution that require kind of a strong partnership with the customer and allows us to deliver value to that customer and drive good pricing. The way we've approached the data center vertical is we've really embedded our engineering resource with those customers to try and solve really high up the value chain the problems they're trying to solve for when it comes to heating, cooling as well as the way they control and the fire and security of their building.

So across the board, if you compare probably the margin of those particular vertical businesses vis-à-vis the rest of the market is probably slightly more than what you see. Now, it's going to continue to evolve as a market over the next few months and years. We've developed differentiated solution from our peers that allows us to command a little bit more price, and we're expecting that to continue drive a better margin profile than the more traditional applied equipment business.

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

And I would add to that also on the product side, we've been ahead of the curve with our reinvestment in product. And so as we've been differentiating our product and gaining position for the next generation of data centers, I believe that we're positioned extremely well with that value proposition. So we believe that the margin profile that we've been able to achieve with what we've done to date is going to continue to improve going forward.

Operator: And today's next question comes from Julian Mitchell with Barclays. Please proceed.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Hi. Good morning. Maybe just wanted to understand, first off, on the restructuring announcement that you made. Maybe help us understand the phasing of the $500 million of sort of cost-out savings and how much of that is reflected in the 2025 operating margin guide? And similarly, on the, I think, $400 million or so of costs for that program, how much is in the free cash flow guide for the current year?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

No, great question and good morning, Julian. So, as with any significant change to a business portfolio, like the divestiture of the Residential & Light Commercial, we've been pursuing opportunities to refine our business structure and our operating model better to really facilitate how we deploy resource in a simpler, more clear and quicker to market. And we have been driving many different aspects of that restructuring as we go through that.

As you know, we still have a business to run until the transaction close. So some of the timing of that cost is going to be hard to predict because it's very attached to the timing of the closing of the transaction. But as any restructuring, we expect the restructuring costs to come ahead of the restructuring benefits. So the $400 million will come ahead of the $500 million. It's not a one-to-one perfectly timed structure.

As we look at the free cash flow conversion guide for the year, we've included a substantial amount of that $400 million into our guide for fiscal year 2025, which is kind of one of the large structural headwinds we had for the year, alongside some CapEx reinvestments in our traditional delta between effective tax rate and cash tax rate. But there's a large portion of restructuring, probably right around half of that, that is including in our guide for fiscal year 2025.

Operator: And today's next question comes from Chris Snyder with Morgan Stanley. Please proceed.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC
Q

Thank you. I wanted to ask about North America Building Solution margins and kind of the outlook into 2025. So, clearly, a lot of pressure on the segment in Q4 on that systems mix. But it sounds like that's supposed to kind of normalize into the first half of the year, I guess, really through fiscal 2025. So can you just kind of talk about what that can mean for Building Solution margins as that mix headwind goes away and what's in the guide for that?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

No, thanks for the question, Chris. Great question. Yeah. It is – I wouldn't say it's material in margin pressure, but you saw North America in the quarter growing extremely rapidly on the back end of those larger project. And those larger systems project come at a margin that is slightly lower than what the service business is able to drive.

So even though the team was able to drive in North America a very solid service growth, it was not enough to compensate, if you like, for the mix effect of those large data center and new energy projects and decarbonization project that the team completed in the quarter. And so, if you look forward, the variation you're going to get quarter-on-quarter on those project will remain, but the headwind that it creates will tail off, especially as we move towards the year because the net effect of service and the service attachment rate, as all the project come live and we start revenuing the service on this particular system project, will start supporting an improved margin rate.

Operator: And today's next question comes from Joe Ritchie with Goldman Sachs. Please proceed.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Good morning.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Morning, Joe.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Marc, maybe just kind of focusing on Global Products for a second. I think you guys said a little volume goes a long way, but these are margins that candidly like we haven't seen before. And so, maybe just kind of dovetailing that question that Nigel had earlier as well. Was there anything kind of one-off in the margins this quarter? And then really just trying to understand what the right jumping-off point is for 2025. So, what was, like, the pro forma Global Products margins for 2024 so that we have that locked in as we think about next year? Thank you.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Very fair question, Joe. So, no, there's no really one timer or mix effect of any particular one deal that really helped that margin. It's really back to the structural work we did and the team did in Global Product over the past 12 months that really set up that business to be able to drive significant operation and efficiencies.

If you want to think about that business from a pro forma continued operation margin, I would say take the 20% margin rate, and I would say the first half of the year will be on one side of that margin rate and the second half of the year will drive well above that 20% margin rate. And I think that business now that has been operating much more efficiently and much more focused as well, we'll be able to continuously perform at that level, if not better.

Operator: And our next question comes from Vlad Bystricky with Citigroup. Please proceed.

And hello, sir, your line is open. You may ask your question. And, Mr. Bystricky, your line is open. You may ask your question.

And, Mr. Sprague, your line is open. You may proceed and ask your question.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Thank you. Good morning, everyone.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Morning, Jeff.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Hey. Maybe just kind of a multi-part question on some of the non-operating items here, so to speak. First, just on corporate, it's kind of interesting that it's nominally roughly the same dollars, $430 million-ish in both cases. I thought the stranded friction would show up there. So, maybe some color on that.

And also, what's taking the tax rate down to 12%? And Marc, I think some of the global changes had you believing your tax rate would actually be drifting up, and instead, we're stepping down here. So maybe you could give a little color on that.

And I just, finally, the share count seems to just imply you're buying back stock, kind of pay-as-you-go, as the cash comes in the door over the balance of the year. Is that correct?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Yeah, I'll start with that last part. You're absolutely right. So, first, I'll start with our guide, the $3.40 to $3.50. Our guide does not contemplate any deployment at all of proceeds associated with the sale of our residential business. So it's just a regular pay-as-you-go, return to shareholder, 100% of our free cash flow.

Now, on your couple question, the corporate expenses, it's flat year-on-year. You would have expected it to be a little higher. We've done a lot of work to lower that cost, but we made also a couple of substantial investment in hardening of cybersecurity and IT infrastructure as well as we are left with those stranded costs that while we want to take action on them, we need to pace and time some of those action with the timing of the divestiture of the Residential & Light Commercial business. We still have a business we got to take care of and we need to continue to provide support for that business.

Now, on your question on the continued – on the CO tax rate, on the continued operation tax rate, we are seeing 100 basis points of pressure year-on-year. So, if you look at pure CO rate, we were at about 11% in fiscal year 2024 and it's stepping up to 12%. You're right, I had indicated that I felt we were probably going to see a little bit more pressure than that. And as we were seeing the Residential & Light Commercial transaction happening, we started planning around that and prepare for that particular headwind. And that allows us to manage a little bit better the rate for 2025.

Now, in all transparency, as you look at 2026 and beyond, we see quite a bit of pressure on that rate because of global mean tax rate and the tax reform globally that have happened. We probably see 400 to 500 basis points to that 12% for fiscal year 2026, as the planning and the closing of that transaction on residential, commercial will be behind us.

Operator: And the next question comes from Andrew Obin with Bank of America. Please proceed.

Andrew Obin
Analyst, BofA Securities, Inc.

Q

Yes, good morning.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

Morning, Andrew.

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

Good morning.

Andrew Obin
Analyst, BofA Securities, Inc.
Q

Just a question. Can we just get more color on applied sales in North America by key verticals? I know the focus is on data centers, but what are you seeing elsewhere? What stands out positively or negatively?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

There's four, five verticals that are really supportive. Of course, data center is one of the critical one. But whether it's healthcare, hospitals, where we're seeing a strong pickup, there's still a lot of activity associated with manufacturing and new energy. The re-onshoring of some of the battery manufacturing has been a great help to our business.

And then finally, overall, as the commercial real estate market is softer, but a lot of that portfolio is rebalancing as people repurpose some of the spaces associated with the post-pandemic reallocation of all that, that office space, it creates opportunity across the domain, not just for applied, to be able to drive new opportunities throughout the market.

Operator: And the next question comes from Deane Dray with RBC Capital Markets. Please proceed.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Thank you. Good morning, everyone.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

Morning, Deane.

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

Morning, Deane.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Hey, question is about the free cash flow guide. Just for fiscal 2025, kind of talk us through what the impact is of taking Resi & Light Commercial out structurally, lower working capital, but just how does that play out and support the 85% conversion?

And then I noticed, you put it in twice longer-term goal of 100% conversion. Marc, just structurally, what has to change to get you to that threshold? Thank you.

Marc Vandiepenbeeck

Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

Yeah. Just to be clear that I – what was in the prepared comment is 100% free cash flow return to shareholder, not 100% free cash flow conversion. No. Longer term, I'm willing to tell you that we will be better than 85%, but we have some structural headwind that we got to continuously deal with.

From a trade working capital, it's not a lower trade working capital. So, trade working capital is going to continue to be a tailwind and support an improvement in our free cash flow conversion. However, there's two or three structural headwinds that become a little bit more weighted to our free cash flow conversion as we separate from the Residential & Light Commercial business that had some structural benefits or were accretive, if you like, to free cash flow conversion if you look at the whole company.

As you know, we were owning about 60% of that joint venture with Hitachi that is now in discontinued operation. That means we would actually get 100% of the free cash flow versus where the earnings landed overall, and the timing of the dividends was not always aligned with the free cash flow generation of that business.

But outside of the discontinued operation, on a continued operation basis to get to 85%, there's a couple of structural headwind. The first one is the restructuring we talked about earlier with Julian as well as we continue to make substantial CapEx investment to continue to increase our data center capacity with the goal to doubling it, and maybe beyond, as we continue to see opportunities in the market.

And then finally, the delta and the effective tax rate, right, between our cash tax rate and our effective tax rate is continued to stay at that 8% to 10% level. I see that coming down as we see pressure on the effective tax rate, but don't see that much pressure actually on our cash tax rate. But for 2025, as we look at it, this will be a headwind.

So, you see improvement in trade working capital with the headwind associated to restructuring, CapEx and taxes overall.

Operator: And the next question is a follow-up from Steve Tusa with JPMorgan. Please proceed.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Hey. Sorry about that.

Marc Vandiepenbeeck

Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

No problem.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

I just want to make sure my math was right on this Global Products margin. I mean, we have about, just backing out, continuing op sales from what you guys reported this year is about $5 billion in revenues for that kind of RemainCo at Global Products. Is that right as a starting point?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc A

The RemainCo of Global Products is probably going to be a little bit less than $5 billion, I would say.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC Q

Okay. So then if I divide that by the 14% whatever, number that you gave as a continuing ops for Global Products' profits, I think that's in the slides, like, that's a high 20s margin, not 20% that you're talking about. Is that – like, am I missing something there?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc A

No, so I didn't say 20%. I said the first half will probably be on one side of 20% and the second half will be on the other side of 20%, but much, much higher than the 20%.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC Q

Okay. So – but the 28% on a pro forma basis-ish, 27%, 28%, is the right kind of base in this year and there's nothing unusual about that. So we should assume that you can leverage volume on that.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc A

We can absolutely leverage volume on that and I think that's the right ballpark, yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC Q

Okay. And then, lastly, sorry, just on data center. You broke up a little bit there. Did you say 15% or 10% data center exposure?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc A

10%.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC Q

Okay.

Operator: And our next question comes from Nicole DeBlase with Deutsche Bank. Please proceed.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc. Q

Yeah. Thanks. Good morning, guys.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

Morning, Nicole.

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

Morning, Nicole.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.
Q

So just a question on, I guess, order growth and backlog. When you guys put together the outlook for fiscal 2025, does the expectation that backlog starts to come down from these record levels or do you think it kind of remains consistent through the year? Thank you.

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

Well, it's going to depend a little bit on the mix of jobs we are going to book in the year and how strong will be the data center vertical. But assuming the trend line we are seeing as well as the growth in our – in the pipeline of opportunities we see in the market, we see that backlog continuing to improve and the margin continuing to solidify.

So, I think the trend is going to be strong in growth in the backlog. That's why we are very comfortable with that mid-single-digit revenue growth, as we are going to be able to drive a lot of revenue out of that backlog.

Operator: And the next question comes from Joe O'Dea with Wells Fargo. Please proceed.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC
Q

Hi. Good morning. Just on slide 5 and the revenue mix, looks like maybe 15% or so indirect. Could you just talk about the end market exposure within that? How you think about that fit within the portfolio on a go-forward basis?

And then, Marc, just with the restructuring announcement today and as you think about proceeds toward the end of the year, just any perspective on how you're thinking about kind of offsetting the exits dilution and sort of timing objectives around achieving that?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc
A

Yeah. So, on the mix, Joe, we view our operating model as an integrated operating model. So, for every market, every vertical, we segment the market by product, sometimes by brand even, and we make sure that we get to a full entitlement from a market share standpoint.

And so for some markets where we see an ability to both sell value, create high service attach rates and being able to drive the lifecycle value of those products in the buildings we're in, we are always going to choose our direct channel and our branches are going to do the vast majority of the work.

Now, there's parts of the markets where maybe it's harder to sell value or that's not where the customer wants to meet us, or the lifecycle value comes in a different profile, either because of the application of the building itself, the type of vertical it addresses or just simply the complexity of that market. It's more commoditized part of the market, more mid to low end of the market. And there, we use and leverage highly our indirect channel through a distribution and sales partner, where we're able to hit mostly the mid to lower end of the market and try and stay away from that more larger complex part of the market.

Now, the second part of your question on capital and restructuring and our ability to offset dilution. The capital deployment plan is going to be very similar to what we've done historically when we've had large divestiture. And you can see how we took that approach, for example, in 2019 when we divested of our battery power solutions business. The goal is going to be able to return as quickly and as efficiently as possible the proceeds of the divestiture, as we see a clear line of sight of closing of the transaction.

The restructuring action, we are going to take them as early as possible. We are not going to wait for the transaction to close. Now, there are certain actions that are going to have to be taken at or after restructuring. So that's why the timing on some of that benefit and cost is a little bit difficult for us to commit to, but we have a clear plan on how to deploy and continue to improve our operating model, as we have throughout the past couple of years.

Operator: And the next question comes from Noah Kaye with Oppenheimer. Please proceed.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Thanks. A couple questions. First, I assume the free cash flow conversion guide doesn't include the tax payments on the divestitures. Would you expect those to fall within the year, just for housekeeping purposes?

Second, just to put a finer point on the answer to the earlier question. The $500 million of benefits over time from restructuring, that's assumed to be immaterial to the 2025 guide. I just want to confirm that.

But then I think more substantively, can you just give us the broad strokes of what the cost-out program entails? And perhaps more qualitatively, how you may be changing the configuration of the business or your go-to-market within that program?

Marc Vandiepenbeeck
Executive Vice President, Chief Financial Officer & President-Building Solutions EMEALA, Johnson Controls International Plc

A

So, Noah, your first two comments, you are correct. So, you're making the right assumption there.

In terms of in all detail, exactly where we're going to focus on, it's around really simplifying and leveraging better our cost structure. With the work we've done over the past six to nine months to rightsize our organization and really get a better grasp around where and how we deploy resources against the market opportunities, further driving that simplification and provide better clarity, and also at the end, improving the customer experience that most of our clients and customers are facing.

Now, from an operating structure, as you see any significant change to a business portfolio, we've been pursuing opportunity to refine the business structure and the operating model to facilitate that simplicity and clarity we talked about. And so, we'll keep you update as we see changes needed in how we operate and present ourselves.

Operator: This concludes our question-and-answer session. I would now like to turn the conference back over to Mr. George Oliver for any closing remarks.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Yeah. I want to thank all of you for joining us today. As we conclude fiscal 2024 and look to the future, I am confident Johnson Controls is heading in the right direction.

Our team has delivered important achievements this year and created momentum entering fiscal 2025. Our customer value proposition is resonating, demonstrated by our sales and service growth and multiple consecutive quarters of building a record backlog.

We are well positioned to capitalize on the opportunities ahead provided by our leadership in Building Solutions and our end-to-end operating model.

So, I want to thank you for your continued support and confidence in Johnson Controls. And with that, operator, that concludes our call.

Operator: Thank you. The conference has now concluded. And thank you for attending today's presentation. You may now disconnect.