Q2 2018 Earnings Call

Company Participants

- Darius Adamczyk, Chairman & Chief Executive Officer
- Greg Lewis, Vice President-Corporate Finance
- Mark Macaluso, Vice President-Investor Relations
- Thomas A. Szlosek, Chief Financial Officer & Senior Vice President

Other Participants

- Andrew Burris Obin, Analyst
- Charles Stephen Tusa, Analyst
- Deane Dray, Analyst
- Jeffrey Todd Sprague, Analyst
- Joe Ritchie, Analyst
- Julian Mitchell, Analyst
- Scott Reed Davis, Analyst
- Steven Winoker, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Please stand by we are about to begin. Good day, ladies and gentlemen, and welcome to Honeywell's Second Quarter Earnings Conference Call. At this time, all participants have been placed in a listen-only mode and the floor will be open for your questions following the presentation. As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Mark Macaluso, Vice President of Investor Relations.

Mark Macaluso {BIO 19081474 <GO>}

Thanks, Cathy. Good morning and welcome to Honeywell's second quarter 2018 earnings conference call. With me here today are: Chairman and CEO, Darius Adamczyk; Senior Vice President and Chief Financial Officer, Tom Szlosek; and Vice President of Corporate Finance, Greg Lewis.

This call and webcast including any non-GAP reconciliations are available on our website at www.honeywell.com/investor.

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Note that elements of this presentation contain forward-looking statements that are based on our best view of the world and of our businesses as we see them today. Those elements can change, and we ask that you interpret them in that light. We identify the principal risks and uncertainties that affect our performance in our Annual Report on Form 10-K and other SEC filings.

For this call, references to earnings per share, free cash flow, free cash flow conversion and effective tax rate exclude impacts from separation costs related to the planned spin-off of our Homes and Transportation Systems businesses, as well as recent tax legislation except or otherwise noted.

This morning, we'll review our financial results for the second quarter of 2018, share our guidance for the third quarter, and then provide an update to our 2018 outlook. And as always, we'll leave time for your questions at the end.

So, with that, I will turn the call over to Chairman and CEO, Darius Adamczyk.

Darius Adamczyk {BIO 18702500 <GO>}

Thank you, Mark, and good morning everyone. Honeywell delivered another outstanding quarter of earnings per share of $2.12, up 18% year-over-year exceeding the high-end of our guidance range. Using our effective tax rate guidance for the quarter of 24%, earnings per share was $2.06, or $0.03 above the high end of our guidance range. Tom will take you through these details momentarily.

Our earnings this quarter were driven by organic sales growth of 6%. The sales growth was strong across the portfolio with double-digit growth in the Aerospace defense business and the SPS warehouse automation business. We expect the sales momentum to continue throughout the second half of the year as our long-cycle orders were up 11% and our long-cycle backlog was up 14% with noteworthy backlog strength in Intelligrated, defense, business aviation, UOP, and HPS services. I will touch on our revised full year guidance in a minute.

We expanded segment margin by 60 basis points, which also exceeded our guide. Strong operational performance drove our exceptional margin result and we benefited from higher volumes, continued investments in commercial excellence, and material productivity. We achieved these results while investing in our future, particularly in Connected enterprises, research and development, and in our global sales force. So far, we've also overcome the impacts of inflation. Greg will cover that in more detail later in the call.

Free cash flow was again a highlight this quarter at about $1.7 billion, up 42% year-over-year excluding separation costs. Conversion this quarter was 108%, the highest second quarter conversion we've had in five years. This continues the improving trends we saw in the first quarter as our HOS Gold working capital toolset continues to deliver results. Finally, we continued to aggressively deploy capital, repurchasing about $800 million in Honeywell shares.

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In total, in the first half, we repurchased about $1.7 billion in Honeywell shares as we continue to take advantage of our opportunities in the marketplace to be more aggressive from a capital deployment perspective. We are also tracking well against the cash repatriation plan we reviewed at our Investor Day in February, which contemplated more than $4 billion of cash being repatriated in 2018. We brought back nearly $2.2 billion into the U.S. through the second quarter.

Today, we are raising our full year 2018 organic sales growth guidance to a new range of up to 5% to 6%; our segment margin expansion to 40 basis points to 60 basis points; our EPS guidance to a new range of $8.05 to $8.15, or up 13% to 15%; and our full year free cash flow guidance to $5.6 billion to $6.2 billion. Compared to prior range, our EPS guidance is now $0.20 higher at the low end and $0.10 higher at the high end. These changes reflect both our second quarter performance and our confidence in the company's ability to continue outperforming for the remainder of the year. Our end markets are strong. We're executing well as evidenced by our margin and cash performance. And we have significant balance sheet capacity to – still to deploy. I'm encouraged by our performance to-date and expect more of the same in the second half.

Let's turn to slide 3 to highlight some of the recent exciting news in our businesses. In Aerospace, Dassault Aviation launched FalconConnect, a comprehensive solution designed to facilitate use, management of – and control of inflight connectivity. FalconConnect is powered by Honeywell's routers, services ground infrastructure and GoDirect connectivity services and is designed to make connectivity as efficient as possible for operators, crews and passengers. It includes both classic and high speed cabin Internet, cockpit safety links, standard ground communications, and a wide range of value-added services designed to maximize data control and minimize cost.

FalconConnect is available on all Dassault Falcon jets, making Honeywell's GoDirect the preferred service provider for operators flying Falcons. Last month, Honeywell released a comprehensive study about the Connected Aircraft, which found that the commercial aviation industry is at the beginning of a five-year technology investment wave fueled by the advances in high speed inflight WiFi connectivity.

The study found that about half of the respondents expect to spend up to $1 million per aircraft on connectivity technologies over the next year and 17% of respondents expect to spend more than $10 million per aircraft over the next five years. Honeywell is at the forefront of innovation when it comes to Connected Aircraft. And we are well-positioned to continue to win in this fast growing space.

In Home and Building Technologies, the building owner of the Burj Khalifa, the world's tallest structure, is currently piloting the Honeywell Connected Building Outcome Based Service, which uses building performance data to focus maintenance activities where they are most needed in order to improve operational efficiency, maximize uptime and improve the integrity of the security systems. So far, the pilot which encompassed the mechanical components of the Burj Khalifa's HVAC system has result in a 40% reduction in total maintenance hours and a significant reduction in unplanned reactive maintenance helping the building operators lower their maintenance costs for this landmark facility in Dubai.

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In Performance Materials and Technologies, ExxonMobil announced that the Honeywell Process Solutions' Experion LCN software approach to migrate their legacy installed base DCS systems eliminates the need for costly rip-and-replace DCS migrations. Experion LCN enables independent longevity of our customers' DCS systems by preserving their intellectual property. ExxonMobil indicated that Honeywell exceeded their expectations, met their challenge two years ahead of the schedule, and gave Honeywell an A on the development of this unique and cost-effective offering.

The comments were made at Honeywell Users Conference Group (sic) [Honeywell Users Group] or HUG which took place in San Antonio last month. The event brings together more than 1,300 customers, channel partners, suppliers and other industry participants from 32 countries to discuss the latest technology and innovations in the process automation space.

Finally, in Safety and Productivity Solutions, Honeywell Intelligrated provided the material handling equipment design, installation, and support for Amazon's new more than 0.5 million square foot distribution center north of Calgary. Once it opens later this year, the facility will complement a larger network of Amazon fulfillment centers throughout Canada.

The Intelligrated system includes more than 4,800 linear meters of conveyor; an IntelliSort high-speed sliding shoe routing sorter, which achieves the highest speeds of any piece of equipment in the facility while maintaining the precision to handle even fragile items; and an even bigger IntelliSort cross-belt shipping sorter that stretches 529 meters in length.

This system helps workers efficiently pick, pack and ship orders so they arrive on the customers' doorsteps on time. Our Connected offerings are transforming the industries in which we participate, leveraging our large installed base to help our customers gain a competitive advantage in the markets they serve.

With that, I'd like to turn the call over to Tom, who will discuss our second quarter results in more detail.

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Thomas A. Szlosek {BIO 6474485 <GO>}

So, thank you, Darius. Good morning. Let me begin on slide 4. As Darius mentioned, we delivered another quarter that was strong across the portfolio and in every financial metric. Organic growth was widespread, with about 70% of the portfolio growing organically 5% or more in the quarter, and about two-thirds of our organic growth coming from an increased volumes.

The markets we serve are strong, and our continued organic sales growth reflects our leading market positions and the investments we've made in new products and in our sales organization. The difference between reported and organic sales is primarily the impact of the weaker U.S. dollar in the first half compared to 2017. For example, the euro averaged about $1.20 in the second quarter of 2018, versus about $1.10 in 2017.

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Segment profit was up 12% in the quarter and segment margin expanded by 60 basis points to 19.6%, primarily due to the benefits from higher sales volumes, commercial excellence and material productivity.

Earnings per share of $2.12, up 18%, and exceeded the high-end of our guidance range by $0.09. This excludes spin-related separation costs of $346 million in the quarter. We'll walk you through the details of the EPS shortly.

Free cash flow in the second quarter of $1.7 billion, up 42%, driven by strong operational performance, particularly in Aerospace and PMT. As Darius mentioned, we continue to be encouraged by the progress on our working capital initiatives and by the additional opportunities that we've discovered through this effort. We continue to deploy capital and, in the quarter, we purchased about $800 million of Honeywell shares bringing our year-to-date share repurchases to about $1.7 billion.

After growth investments and paying a competitive dividend, our preference is to deploy capital to M&A. But in the absence of immediate opportunities, we'll continue to opportunistically repurchase outstanding shares. As Greg will share with you shortly, we anticipate continuing this repurchase activity in the second half. Overall, strong performance across the board.

Slide 5 walks our earnings per share from the second quarter of 2017 to the second quarter of 2018. The majority of our earnings growth, $0.24, came from segment profit improvement driven by enhanced sales volumes across the company, the impacts from our commercial excellence efforts, productivity improvements realized through HOS Gold, and savings from previously funded and executed restructuring projects.

Below the line items were a $0.05 tailwind this quarter, primarily due to higher pension income driven by the strong investment performance in the plan and a lower discount rate. This impact was partially offset by higher funding or new repositioning on other projects in the quarter, including about $60 million in high-return restructuring projects.

The share repurchase actions in the second quarter resulted in a lower weighted average share count of 755 million shares. Combined with the slightly higher earnings attributable to non-controlling interests, the share repurchases were a $0.04 tailwind to EPS.

We had planned and guided our tax rate at 24% for the quarter, compared to 21.3% last year, which would have resulted in a $0.07 headwind to EPS. At this higher 24% planned tax rate, our earnings per share would have been $2.06, above the high end of our guidance range by $0.03. We realized a further $0.06 EPS upside from the lower actual tax rate of 21.7% versus that 24% guided rate for the quarter. The tax rate was lower than guided primarily due to the successful resolution of several tax audits.

So on a year-over-year basis then, the actual tax rate for the second quarter of 21.7% was slightly higher than the tax rate for 2017 of 21.3%. And despite this headwind, we still achieved an 18% increase in earnings per share.

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Going forward, we expect the pro forma tax rate for the remainder of the year to be similar to our second quarter tax rate, resulting in an estimated rate for the full year that is still in the 22% to 23% range of our original guidance.

Our EPS guidance excludes any potential adjustments to the charge we recorded in the fourth quarter of 2017 relating to the U.S. tax legislation, as well as separation costs associated with the two spinoffs.

In the second quarter, we incurred $346 million or $0.46 of separation costs, $291 million of which were tax costs incurred in the restructuring of the ownership of various legal entities in preparation for the spinoffs. Separation costs to-date are in line with our expectations.

Other items composed of adjustments to the fourth quarter U.S. tax legislation charge were a $0.02 benefit to EPS. So netting out the two items resulted in a $0.44 change in reported earnings per share to $1.68.

Let's turn to slide 6. Our Aerospace business is performing well in an extremely robust demand environment. Air transport and regional flight hours were up 7% and, as you know, the backlogs of our major OEM customers are at record levels.

Despite the challenge that this level of demand creates for our supply chain, Aerospace sales were up 8% on an organic basis. We had 14% organic growth in Defense and Space, with higher spares volumes on U.S. Department of Defense programs, strong demand for sensors and guidance systems, and robust shipment volumes on key programs, including the F-35.

And in Commercial OE, sales were up 7% organically, driven by robust HTF engine demand in business aviation, air transport deliveries on key narrow-body platforms including the Boeing 737 and the Airbus A320, and lower customer incentives which added a point of organic growth to Aerospace in total in the quarter.

Organic growth in the Aftermarket of 4% was driven by Maintenance Service program activity in business aviation and strong airlines demand. In addition, our Connected Aircraft software offerings have grown more than 15% year-to-date driven by demand for our GoDirect Cabin software.

In Transportation Systems, sales were up 7% organically on continued growth in passenger vehicle gas turbos in China, Europe and South Korea, stemming from new launches and higher commercial vehicle turbo volumes in North America and China.

Aerospace segment profit was up 12% and segment margin expanded 30 basis points driven by higher sales volumes, commercial excellence, and lower year-over-year customer incentives. In the quarter, there was a 30-basis-point headwind from foreign currency primarily in Transportation Systems business.

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In Home and Building Technologies, organic sales growth was 3% for the quarter. Homes grew 7%, driven by continued double-digit growth in residential thermal solutions and strong thermostat demand in North America and Europe. Similar to the first quarter, sales grew across all regions in ADI.

In Buildings, organic sales were flat year-over-year. The commercial fire business was strong in North America and Europe as well as our Connected Buildings business driven by demand for our Tridium building management platform. In addition, activity in the high-growth regions within Building Solutions was robust with double-digit organic sales growth in the quarter, primarily in India.

However, the overall Buildings organic growth was tempered by slower bookings and revenue conversion in the North America Energy vertical in Building Solutions. HBT segment margins expanded 60 basis points driven by commercial excellence, the benefits from previously funded and executed restructuring, and higher sales volumes.

In Performance Materials and Technologies, sales were up 3% on an organic basis, driven by growth in Process Solutions and UOP. Sales in Process Solutions were up 5% organically, largely due to solid backlog conversion in the project automation and solution business and significant growth in the service business. UOP sales were up 3% organically, driven by engineering and catalyst growth, the latter being driven by new units in China and refining catalyst reloads. The clients in gas processing and hydrogen from lower modular gas equipment sales partly offset the growth in the rest of UOP. UOP backlog was up 7% in the quarter, pointing to continued steady sales growth for the second half.

In Advanced Materials, there was continued growth in Solstice low global warming products within Fluorine Products, however, this was offset by lower volumes and a temporary unplanned plant shutdown in Specialty Products. PMT segment margins expanded 50 basis points driven by commercial excellence benefits from previously funded and executed restructuring, and higher volumes, partly offset by inflation and a temporary lower weighting of higher margin sales within the catalyst and gas processing businesses.

In Safety and Productivity Solutions, sales were up 11% on an organic basis. We had another strong quarter at Intelligrated with continued new projects activity in the e-commerce area. Intelligrated's orders growth this quarter was again very strong, up more than 40%, adding to an already robust project backlog. There was double-digit growth in Productivity Products driven by demand for a new Android-based Mobility product offerings, coupled with strong growth in scanning and printing applications. The Android launches that we've been previewing are gaining traction with our customers and winning versus the competition in the marketplace.

Organic growth in the Safety business was 5% with strength in the gas protection and high-risk product categories. Additionally, the SPS China and India businesses each grew more than 20%. SPS generated impressive margin expansion of 150 basis points enabled

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by higher sales volumes, commercial excellence, and benefits from previously funded and executed restructuring. We're extremely pleased with SPS' performance this quarter.

Greg is now going to cover our outlook for the third quarter and the rest of the year. But before he does, I want to reaffirm the confidence I expressed in Greg when we announced in April that he's taking over as CFO of Honeywell effective August 3. Greg and I have worked together since he joined Honeywell in 2006. I can assure you that he has the business acumen, finance acuity, determination and commitment required to excel as the CFO of Honeywell. Working with him every day for the last three months on the transition has only reinforced my confidence. I'm a shareowner and I will sleep well with Greg at the helm.

So, over to you, Greg.

Greg Lewis {BIO 20594853 <GO>}

Thank you very much, Tom. I appreciate the confidence.

Let's move on to slide 7 and I'd like to start by discussing two important items as a backdrop to our forward look, tariffs and the spins. Let's start with tariffs. We're proactively managing both the direct and the indirect impacts from the Section 232 and Section 301 tariffs. We've evaluated and addressed the list of the first $50 billion of goods affected by Section 301, as well as the retaliatory offsets, and are currently assessing the potential additional $200 billion of targeted tariffs.

We have seen inflation accelerate in a number of areas within the business, most notably in transportation and logistics and in metals. And our procurement, marketing and commercial excellence teams are proactively working on offsets to minimize the impact to our P& L.

Based on the tariffs enacted to-date and our mitigation actions across the portfolio, we anticipate a minimal impact to our overall business results in 2018. But this is a very dynamic situation that changes by the day, as further evidenced by this morning's headlines and we're giving it substantial focus. We've established a robust set of processes in each of our businesses and at the corporate level to ensure we stay on top of the situation.

For the known items, we are monitoring and rigorously addressing cost increases to our supply chain and adjusting our pricing as necessary. I'm encouraged by what our teams have accomplished so far. Now for 2019, we're evaluating more structural solutions for longer-term tariff impacts, and including potentially bringing on new sources of supply where needed.

Now, let's discuss our progress on our two spinoffs, Transportation Systems and Homes. Both businesses are being operationalized and we're making great progress on building up the leadership teams for each. Earlier this week, you saw the appointment of Carlos Cardoso, as Chairman of the Board of Transportation Systems, which will be called

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Garrett. We're pleased to have a leader with such an impressive track record to strengthen an already well-equipped global business leadership team led by Olivier Rabiller.

On the external side for both spins, we have filed the draft Form 10s with the SEC and are working through the comment letter process for each. We have completed rating agency presentations and are preparing for the debt and equity road shows for both companies. In short, we are on track for the completions of both spins in 2018 and both businesses are performing well as you saw. And we look forward to updating you as the spin dates become clearer.

Lastly, just a reminder, that both our quarterly EPS guidance and our full year guidance includes earnings for both spin companies for the full year and excludes separation costs related to those spins and any adjustments to the tax charge we recorded in the fourth quarter of 2017 related to U.S. tax reform. We had a minor favorable adjustment to the charge in the second quarter. These favorable adjustments may be larger in the second half of the year and we'll provide you with updates as we move forward.

Now, let's move to slide 8 and we'll discuss our outlook for the third quarter. Overall, our strong order rates and a growing backlog are expected to drive third quarter organic sales growth in the range of 5% to 7%. Segment margins are expected to expand 30 basis points to 50 basis points, driven by those increased volumes, commercial excellence and material productivity, similar to what we saw in the second quarter. We anticipated third quarter earnings per share of $1.95 to $2 or growth of 11% to 14% with a tax rate of approximately 22%.

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Moving onto the businesses. In Aerospace, we expect continued strength in Commercial Aviation Original Equipment sales with higher shipment volumes on the Boeing 737, the Embraer L450 and L500, and Dassault F8X platforms. Used business jet inventories are at their lowest level since before the financial crisis. A number of new aircraft certifications will occur in 2018 and we have good positions on the right platforms across the super mid-sized and large business jet cabin aircraft.

In the Aftermarket, we expect continued demand driven by airline flight hours growth in ATR and Maintenance Service Plan activity in business aviation. We anticipate continued double-digit growth for the Connected Aircrafts driven by demand for JetWave hardware and GoDirect services.

In Defense and Space, we expect another strong quarter, driven by demand for sensors and guidance systems in the U.S. and abroad and spares volume into U.S. DOD and international defense programs. Within Transportation Systems, we expect strong gas turbo demand, driven by new platform launches in Europe to continue.

In Home and Building Technologies, we expect strong demand from our commercial fire and Connected Buildings technologies, but this was largely be offset by the impact of declines in the Energy backlog in Building Solutions in the first half. Within Homes, we anticipate continued growth in products, driven by demand for thermostats and residential thermal solutions and continued strength in ADI.

On Performance Materials and Technologies, we are anticipating healthy growth in each of our businesses in the third quarter. In Process Solutions, we expect continued backlog conversion in the projects business and short-cycle demand in the software and life cycle solutions and services businesses, driven by our strong first half short-cycle orders growth.

In Advanced Materials, we expect continued strength from customer adoption of our Solstice low global warming products and Fluorine Products and better volumes in Specialty Products.

In UOP, we expect robust equipment, engineering and catalyst demand with continued growth from new catalyst units in China. Based on the timing and composition of those expected catalyst shipments in the second half, we do expect that PMT margins will be down in the third quarter but those margin rates will significantly increase in the fourth quarter. Those quarter-to-quarter dynamics are not unusual in this business and I believe we've talked about them before.

Finally, in Safety and Productivity Solutions, we expect continued outperformance in Intelligrated, driven by strong orders growth and project backlog awarded in the first half of 2018. In Productivity Products, we expect that our new Mobility product launches continue to gain momentum in the marketplace, building on a strong second quarter.

In Safety, we expect growth in all industrial safety categories and continued growth in retail as we approach the holiday season. China and India are each anticipated to have another quarter of double-digit growth.

Now, moving to slide 9 to discuss our full year guidance. As Darius mentioned, we've raised our full year sales, segment margin, earnings per share, and free cash flow guidance to reflect our strong performance in the second quarter and confidence in our outlook for the second half of 2018. Our revised guidance incorporates the minor impacts of the currently known tariffs. We'll continue to monitor the plans to address the impacts, if any, from other potential tariffs that had been announced but not yet enacted.

Full year organic sales are now expected to be up 5% to 6%. This is driven by favorable conditions in our end markets, our emphasis on organic growth initiatives like commercial excellence and continued penetration at the high-growth regions along with robust long-cycle order rates and backlogs. We've narrowed our segment margin guidance to 40 basis points to 60 basis points, the high-end of our prior range, which reflects our strong first half and confidence in strong sales volumes in the second half.

We've significantly increased our free cash flow guidance to a new range of $5.6 billion to $6.2 billion driven by higher net income and better working capital performance across the business as you've seen in the second quarter. This new range implies conversion of 92% to 100% a strong improvement from the 90% we posted in 2017.

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Our estimate for the full year effective tax rate continue to be between 22% and 23%. We have also raised our full year EPS guidance by $0.20 on the low end and $0.10 in the high end, as Darius mentioned. This new range of $8.05 to $8.15 represents earnings growth of 13% to 15%. Our guidance reflects a revised weighted average share count of 754 million shares which includes the $1.7 billion in share repurchases in the first half and an estimate of the repurchases planned for the remainder of 2018. We anticipate this will provide a $0.03 benefit to EPS in the second half of the year versus our previous guide.

On a segment level, we now expect Aerospace organic sales growth to be 7% to 8% versus the previous guidance range of 3% to 5%, driven by the continued recovery of the business aviation market and robust demand within our Defense business.

In Home and Building Technologies, we raised the low end of our organic sales guidance by a point to 2% to 3% and the low end of our margin guidance by 10 basis points to 30 basis points to 50 basis points improvement.

Our organic growth and margin outlook for Performance Materials and Technologies has not changed. However, we have updated the reported sales outlook to reflect the headwind from foreign currency translation in the second half of the year.

In Safety and Productivity Solutions we have increased our organic sales growth expectations to 7% to 8% versus the previous guidance range of 4% to 6% and increased our segment margin guidance to a new range of 16.0% to 16.2%, up 90 basis points to 110 basis points for the year.

Safety and Productivity Solutions had an outstanding second quarter and our investments in the Intelligrated business and the new Android-based product launches within Productivity Products are delivering for us. Our revised outlook reflects increased confidence that SPS will continue to deliver in the second half of the year.

So, let's wrap up on slide 10. Honeywell delivered outstanding operational performance in the second quarter with 6% organic sales growth, 60 basis points of margin expansion, 18% earnings growth, and 42% free cash flow growth. On top of our financial performance, we've continue to make significant progress in becoming a software-industrial leader.

Our Connected offerings are helping our customers solve critical challenges across our large installed base. We expect the momentum we have seen in the first half of the year to continue into second half. Our orders rates remain strong and our backlog continues to grow.

Soon, we will spinoff our Transportation Systems and Homes businesses. We have made great progress to prepare both to standalone as independently publicly traded companies. We look forward to sharing more on our continued strong performance with you as the year progresses.

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And with that, let's move to Mark for Q&A.

Mark Macaluso {BIO 19081474 <GO>}

Thanks, Greg. Darius, Tom and Greg are now available to answer your questions. So, Cathy, please open the line for Q&A.

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Q&A

Operator

Thank you. The floor is now open for your questions. Our first question is coming from Joe Ritchie of Goldman Sachs.

Q - Joe Ritchie {BIO 16351356 <GO>}

Thanks. Good morning, everyone.

A - Darius Adamczyk {BIO 18702500 <GO>}

Good morning.

Q - Joe Ritchie {BIO 16351356 <GO>}

Greg, welcome to the call. And, Tom, it's been great working with you the last five years. Wish you nothing but the best in retirement.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Thanks, Joe.

A - Greg Lewis {BIO 20594853 <GO>}

Thank you, Joe.

Q - Joe Ritchie {BIO 16351356 <GO>}

Maybe just starting off. Obviously, organic growth has been really good the last four quarters. You're taking up the organic growth guidance for the year. It's interesting to see that long-cycle backlog continuing to grow double-digits as well. So maybe, Darius, just touch on how much visibility do you already have going into 2019 just based on how good your long-cycle businesses are performing today?

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A - Darius Adamczyk {BIO 18702500 <GO>}

Well, I mean, if you kind of think about that 60/40 split that we talked about before, obviously, I'm gaining more confidence by the day because that kind of backlog growth, double-digit backlog growth, double-digit growth in orders is tremendous. We are actually very bullish also on the PMT segment kicking in much more significantly in the second half based on the activity of our pipeline.

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So, obviously, as I look forward to 2019 – although, I'm still focused on 2018. We've got a couple of quarters to go – but there's no question that based on what we're seeing, things are shaping up nicely for another strong year in 2019 based on current activity.

Q - Joe Ritchie {BIO 16351356 <GO>}

Yeah. It seems like it. And it was interesting to see you guys call out Amazon today. I think that was the first time at least that I'd heard their name mentioned. I'm just curious like whether you're starting to deepen your relationship there and maybe just any color around that specific project in Canada would be helpful?

A - Darius Adamczyk {BIO 18702500 <GO>}

Amazon's been a great customer. We've had a long-term partnership. In some ways, we're a supplier and a customer. So it kind of goes in both directions. The Intelligrated solutions are extraordinary well respected and they hit the part of warehouse automation that's growing the fastest, and that's around e-commerce. I've talked about that before that that is truly the sweet spot of Intelligrated offerings is in the high-speed, high-throughput. That's a solution that's second to none, and we're seeing that being reflected in our growth rates. And as I said before on a number of calls, this will turn out to be probably the best acquisitions we've ever done, and I continue to feel very strongly about that.

Q - Joe Ritchie {BIO 16351356 <GO>}

Got it. Maybe if I could sneak one more in. Look, you guys have been talking about this improvement in cash flow now for a couple years and we're really starting to see the benefits of it. Just curious whether there were any kind of one-time benefits that helped you this quarter on the cash flow conversion? And how are you guys are thinking about that now that you've raised your guidance for the year on the free cash flow side?

A - Darius Adamczyk {BIO 18702500 <GO>}

No, I'm glad you asked that question, Joe, because, to me, that's a real highlight of the quarter. I mean, I really think that the kind of focus we've had within the company on working capital, on terms, on executing on our inventory, receivables, all those things are really kind of coming together and being reflected. Our working capital turns are getting better. We're driving less capital intensity where a lot of the investments that we made are paying off. And it's a really, really nice story and it kind of all came together here in Q2 cash flow, and we expect that momentum to continue.

So we feel good about what we're doing. We'll continue to add more tools to HOS Gold to help our teams drive working capital, and it's really gratifying to see a lot of that come through in the numbers. And we're not done. We've got more tailwinds ahead of us. So...

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Yes. Maybe I could just add to that. This has been a four-quarter story. I mean, we've got four-tenths of a turn improvement versus a year ago, but you're seeing, sequentially, each quarter that number continues to get better. We've improved it by about a tenth of a turn

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in each of the most recent four quarters. So that is definitely a momentum shift with the efforts that have been going on around the business.

Q - Joe Ritchie {BIO 16351356 <GO>}

Thanks, guys. Nice quarter.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Thank you.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thanks, Jeff.

Operator

Our next question will come from Scott Davis of Melius Research.

Q - Scott Reed Davis {BIO 2393277 <GO>}

Hi. Good morning, guys.

A - Greg Lewis {BIO 20594853 <GO>}

Good morning.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Good morning.

A - Darius Adamczyk {BIO 18702500 <GO>}

Good morning, Scott.

Q - Scott Reed Davis {BIO 2393277 <GO>}

I'll share a similar commentary. Tom, it's been a pleasure. You've had a great run and deserve a lot of credit for following in some big footsteps of Mr. Anderson. And, Greg, I'm sure you'll do a great job as well. So it's been a pleasure.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Thanks, Scott. Thank you.

A - Greg Lewis {BIO 20594853 <GO>}

Thank you.

Q - Scott Reed Davis {BIO 2393277 <GO>}

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Anyways, guys, there's not been much to pick on with you folks in a couple years. But the Buildings side of the business is one that I always kind of struggle to figure out whether this is a good business or not a good business. But what do you think keeps the building owners from spending money? I mean, there should be cash flowing pretty well right now. Why aren't they investing more heavily? Do you guys have a sense of that?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah. I mean, I think, frankly, it's a little bit of – we have to do an even better job of communicating the value of our Connected Buildings. But as we talked about in some of our win examples, when you secure a building like the Burj Khalifa, which is kind of the – probably as prestigious a building as there is anywhere in the world, and the building owner sees the value in our Connected Building solutions, that tells you something. So I think that there is more headway here for us.

Frankly, also in Q2, we had some operational issues on the electronic side, so this print could have been a little bit better than it actually was. We're working through a backlog situation that should correct itself in Q3 and Q4. But, overall, we feel pretty good about the kind of offerings we had.

And I'd say something else in the Connected Buildings. We're in different steps of evolution of our all our Connected plays, whether it's Connected Aircraft, Connected Buildings, plants and so on. I actually think a lot of the solutions that we have in Connected Buildings are more commercial-ready than maybe a lot of the other offerings that we have. So we've installed a new leader in HBT. We have a great deal of confidence in Vimal. He has a tremendous track record in Process Solutions, and we're very confident he's going to do the same in HBT.

Q - Scott Reed Davis {BIO 2393277 <GO>}

And just as a quick follow-up guys, what percentage of your revenues you think are Connected now? I mean, I know you have got a big potential for connectivity, but was it something you can really measure at...

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, it's north of $1.5 billion. It's purely the Connected revenues. That's not the total software business, just to be clear.

Q - Scott Reed Davis {BIO 2393277 <GO>}

Yeah, understood. And I imagine that strong free cash flow as well probably, right?

A - Darius Adamczyk {BIO 18702500 <GO>}

Absolutely.

Q - Scott Reed Davis {BIO 2393277 <GO>}

Yeah. Okay. Thank you. Appreciate it, guys.

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A - Darius Adamczyk {BIO 18702500 <GO>}

Thanks, Scott.

A - Greg Lewis {BIO 20594853 <GO>}

Thanks, Scott.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Thanks, Scott.

Operator

We will now move to Steve Tusa of JPMorgan.

Q - Charles Stephen Tusa {BIO 17373535 <GO>}

Hi, guys. Good morning and congrats to Greg. Tom, thanks for all your help. Congrats also on a great run.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Thank you, Steve.

A - Greg Lewis {BIO 20594853 <GO>}

Thanks, Steve.

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Q - Charles Stephen Tusa {BIO 17373535 <GO>}

And Darius, I think you can shorten the intro on Intelligrated and just say Amazon and I think people will be pretty happy with that. So, just some advice there. Anyway, just kidding around. So, I think, Scott, took care of most of the nitpicking here. On free cash flow, again, kind of this year, the progress you've made, would you expect to kind of continue to see progress into 2019? I mean, are these the types of things that, with the business mix and with what you're doing, that you can kind of grow that again a little bit faster perhaps than earnings whatever earnings may grow in 2019 as well?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, absolutely, Steve. I mean this has – if you go back to the playbook and I'll say the playbook really came out all the way in Investor Day of 2016. And you think about all the factors that I talked about, right, which is accelerating our organic growth rate, continued margin enhancement, improved cash conversion, transforming to a software-industrial, and deploying – be more aggressive around capital deployment. I think, when you put all those things together, we can point clear signs that every one of those things that we're doing. And obviously, cash conversion was one of those elements. We committed to be in the 90s this year. I feel even more confident of us being there and I continue to be bullish about us making progress in 2019 and beyond.

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Q - Charles Stephen Tusa {BIO 17373535 <GO>}

And then, you guys – I believe you bought back another $700 million worth of stock this quarter. And it's a little bit kind of late in the year for M&A, at least, to close. So, there's what seemed to be a decent amount of cash that's kind of left over when you think about the kind of annual run rate of potential. Is that the kind of fair way to look at it, that if we get through another quarter, we'll be pretty consistent on this buyback phase, or are you more or less bullish about kind of the acquisition pipeline here?

A - Darius Adamczyk {BIO 18702500 <GO>}

No, we're – I have, by no means, given up on getting an acquisition closed this year. I think we still have a shot to do so. We're looking at a number of things. You never know which way they're going to go. I mean, so far, a lot of them have gone left rather than right for one reason or another but we're far from giving up in getting a decent acquisition done here or maybe even a couple. But the calculus has always been, okay, if we can't deploy capital to acquisitions, bolt-ons, which has always been our preference, then we're going to deploy back in the form of buybacks. And I thought it was a very attractive entry point as I talked about it at the end of Q1 in the $1.40s. So, I was more than happy to buy back the shares.

Q - Charles Stephen Tusa {BIO 17373535 <GO>}

And how much – if you did no deals from here on out, how much should you be able to buy back this year?

A - Darius Adamczyk {BIO 18702500 <GO>}

Well, I mean – it's – we've got a lot of cash on the balance sheet but I'm not planning on spending all of it.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

And we talked about, at the beginning of the year, of having capital deployed of $5 billion to $6 billion in total for the full year. And that's available capital. That's not – we're not committed to like spending every single dollar of that but it just gives you a sense that that's healthy. And with a better free cash flow, I think we'll have more opportunity.

A - Darius Adamczyk {BIO 18702500 <GO>}

Yes, I mean, the framework I think that I provided, Steve – just to be consistent and I'd still stick with it which is – if you think about a dividend some place around the $3 billion mark for the two spins, I'm going to have to use some of that to pay down debt, something in the $1 billion to $2 billion range. The rest of that, I'm committing to buybacks so I'm – kind of done that already. On top of that, I would do what I need to do to keep share count flat, which is another half or so. And then, on top of that, I might do a little bit more. So, that's kind of a rough framework. And it's a little bit – the calculus gets a little fuzzy depending upon whether or not we do have a transaction. It's going to be a little bit less if we do another transaction; it might be a bit more if we don't. And also, we see where the entry points are.

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Q - Charles Stephen Tusa {BIO 17373535 <GO>}

No, it's clear. Having more cabbage is better than not having any cabbage. That's very clear. Thanks, guys.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thanks.

A - Greg Lewis {BIO 20594853 <GO>}

Thanks, Steve.

Operator

Thank you. We'll now go to Jeff Sprague of Vertical Research.

Q - Jeffrey Todd Sprague {BIO 1494958 <GO>}

Thank you. Good morning, everyone, Jeff and all around. I won't say anymore. We're getting a little misty-eyed on this call, but best of luck, Tom. I just want to, again, come back to cash flow. And Darius, as you're probably well aware, actually, your conversion is a lot better than it looks to the naked eye, right? Given non-cash pension income there is here.

A - Darius Adamczyk {BIO 18702500 <GO>}

Exactly.

Q - Jeffrey Todd Sprague {BIO 1494958 <GO>}

So now that we're...

A - Darius Adamczyk {BIO 18702500 <GO>}

Glad that you asked.

Q - Jeffrey Todd Sprague {BIO 1494958 <GO>}

...kind of – yeah, no, it's extraordinary. And so, now that we're kind of approaching a level where cash flow per share is kind of in line with your EPS guidance, per se, what do you think about maybe trying to do something on pension and kind of taking that out of the equation here? I don't know if you can extract value from it or not. Obviously, it's in great financial shape but just would love to hear your thoughts on that.

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah. Well, yeah, I mean, obviously that's something we've thought about. We de-risked half of it, so half of that exposure is gone. Our pension is funded at like $113 million, $114 million range. So even if you think about some kind of a major step back in terms of the market at 20% reduction, we'd still be fully funded.

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So, do we – the first – there is some benefit having some below the line income as well come through. It does hurt cash conversion, but there are some benefits as well. So, obviously, we're thinking about that. No further decisions have been made. But I thought taking at least half that risk completely off the table, like we did earlier this year, was wise particularly given were the markets were. And we'll see what we do from here.

Q - Jeffrey Todd Sprague {BIO 1494958 <GO>}

And then, separately, just if we can, can we put a finer point on spin timing? Do you think turbo can still be a Q3 event? Or is there a little bit of implicit slippage? And just your commentary here about both being a second half event.

A - Greg Lewis {BIO 20594853 <GO>}

Yeah. No slippage. We are going according to plan. I think we talked about the end of the third quarter for turbo and that is well aligned with our current thinking. Homes is also coming right behind it. We're very much in the throes of the preparations there as well, so nothing different. I think we feel pretty good about the things that we can control. And obviously, with the SEC process, that one is a bit out of our hands, but it's going well.

Q - Jeffrey Todd Sprague {BIO 1494958 <GO>}

Great. Thank you.

A - Darius Adamczyk {BIO 18702500 <GO>}

Okay. Thanks.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Thanks, Jeff.

Operator

And we now move to Julian Mitchell of Barclays.

Q - Julian Mitchell {BIO 21229700 <GO>}

Thank you. Good morning. And thanks to Tom and welcome to Greg. Maybe just first question about Aerospace. Just wondered how long you thought it was sustainable for Defense and Space to keep outgrowing Commercial Aftermarket by such a distance? And also, I guess in Commercial Aftermarket. Should we expect some recovery there or acceleration over the next 12 months given the favorable macro?

A - Darius Adamczyk {BIO 18702500 <GO>}

On Defense and Space, they continue to be bullish given what we're seeing in the – not just the U.S. Defense budgets, that's certainly positive, but also lot of the NATO countries' defense budgets. They – I don't know if they're all going to reach the 2% of GDP level but it's very clear that many of them are going up. So, that's – that continues to be – continue to be bullish on that segment.

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In terms of kind of the Aftermarket part of our business, I think couple of things to point out. One is, we're shifting more of that mix to longer-term contracts. So, as – I discussed this a little bit at the end of Q1. So, we're going to see a little bit more of a kind of steady state rather than kind of complete alignment with flight hours. We still feel good about what we did. Two is, we have a little bit more of an avionics versus mechanical focus versus some of the others which probably see greater even higher correlation to flight hours. And three is, we are still very much in kind of a past due situation on the backlog. I mean, we are seeing some challenges in kind of the Tier 3, Tier 4 supply chains, and frankly, these numbers could have been even better and we're working through those to – and we expect to really be in a much, much better shape by the end of the year.

But, nevertheless, things are a bit constrained on the supply chain and I think it's very consistent with what you're hearing from a lot of the other Aerospace players as well.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Yeah. I would add that, I think that we're going to be fine on the Aftermarket but it is tough to compete with the Defense backlog. I mean, you saw the growth rates in the quarter and the backlog is up well into the double-digits. So, when does that stop nobody really knows. But right now, for the foreseeable future, that is very strong backlog to work from as well. So, we have both of them going in the right direction.

Q - Julian Mitchell {BIO 21229700 <GO>}

Thank you. And then my second question would be switching to Safety and Productivity. So, obviously, very good growth in Productivity within that. My assumption would have been that a lot of that was fueled by large projects that businesses like Intelligrated that might carry a lower margin. So, I'm intrigued, I guess, by the extent of the margin uplift in the guide at SPS. So, maybe give any color I guess around what's going on in that margin guidance uplift?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah.

Q - Julian Mitchell {BIO 21229700 <GO>}

And are you seeing much better margins on large projects perhaps that you might have done historically?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah. Well, a couple of comments. I think, certainly, we're seeing better margins there in Intelligrated. The other thing, let's not forget that it's been – it's a really nice story in SPS throughout all our businesses. Granted, Intelligrated grew faster than a number of the others. But if you – let's say, look Productivity Products which really had a really nice quarter this quarter, double-digit growth, substantial margin expansion, and this is very consistent. If you go back to a lot of the earnings call – last year, I talked about us getting that business back on track and I'm very pleased to see that John and the team really kind of got that business going again. It's – was a tremendous story. Our SIoT business had another strong quarter. So the kind of margin expansion growth we're seeing in SPS is just – it's not just limited to Intelligrated, it's really across the board. There isn't a single business that didn't have a good quarterly in SPS.

A - Greg Lewis {BIO 20594853 <GO>}

Yeah, and if I could just add. I mean, there is a lot of self-help in the businesses that we had. And if you remember part of the Intelligrated thesis, is we have other businesses with that business model and part of the integration benefits is some of those practices coming over from the HPS projects business as an example to the Intelligrated projects business, so that we'll run that more efficiently and they're starting to adopt some of those things as well. So that's part of the expectation of what we had laid out when we bought the business also was to be able to help it run itself on a much more efficient basis as part of Honeywell.

Q - Julian Mitchell {BIO 21229700 <GO>}

Great. Thank you.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thanks, Julian.

Operator

Our next question will come from Deane Dray of RBC Capital Markets.

Q - Deane Dray {BIO 1722688 <GO>}

Thank you. Good morning, everyone. I add my congrats to Tom and Greg.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Thanks, Deane.

A - Greg Lewis {BIO 20594853 <GO>}

Thank you.

Q - Deane Dray {BIO 1722688 <GO>}

I know this is under the category of high-quality problem. But when I hear Intelligrated orders up 40%, it just raises concerns about whether you might be taking on too much, your potential risk of over-promising, under-delivering and maybe your pricing is not appropriate if you're seeing that kind of order surge. So just kind of talk us through that. I know it's a high-quality problem, but just take us through the implications of such rapid growth?

A - Darius Adamczyk {BIO 18702500 <GO>}

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Yeah. Well, let's start with the pricing because there's a couple of different questions. I mean, I would tell you that Intelligrated margins are expanding, not contracting. A lot of that is due to self-help. We're becoming much more efficient. We're leveraging a much broader global footprint to complete the work. And, frankly, this is a technology business. When you can process 400 boxes a minute versus 350 boxes, customers are willing to pay for that. And I would say that right now and if this is going to continue to stay this way, this is the best technology available in the marketplace. So it's pretty clearly to see why we are where we are.

In terms of that kind of growth, 40%. It's not surprising to us. We've known that this was coming. We continue to be very bullish about a lot more growth. So you guys should expect kind of double-digit orders growth here in the second half as well. And we've been preparing for it. We're building out capacity, capability, and we're staffing up very, very quickly. We're exceptional at project execution. That's also why we win as often as we do.

And, frankly, Intelligrated team is using a lot of the HOS Gold toolkit to continue to execute and also leveraging a lot of the things that were done in Honeywell Process Solutions because the leader now of Intelligrated is somebody who was a leader in HPS. So all those things are kind of coming together, and I feel very bullish on our ability to be able to process that backlog successfully.

Q - Deane Dray {BIO 1722688 <GO>}

Good to hear. And just a separate question for Tom and/or Greg. Is the idea on tax reform is there might have been some – it might be some simplification opportunities in your tax structure? We talked about that before. Is any of that beginning to come through? And maybe you can't tell yet with the work you're doing on the spins and separation of legal entities, but just what's your line of sight on the simplification of your tax structure and some cost savings that might fall through?

A - Greg Lewis {BIO 20594853 <GO>}

Yeah, great. That's a great question. We are working through that real-time as you can imagine. And as you alluded to, the spins do play a role in creating some of that clarity. So that as we get closer to the spins, we'll have a better view on exactly what those impacts will be. But we are working on exactly that as we speak. And, as I alluded to in the outlook, I think in the second half of the year, as that does become much clearer, we'll be able to give you some more specifics about what that impact will be. But for certain, we will have a more simplified structure as we go forward and adapt to the new tax legislation.

Q - Deane Dray {BIO 1722688 <GO>}

Thank you.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you.

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Operator

The next question will come from Andrew Obin of Bank of America.

Q - Andrew Burris Obin {BIO 6337802 <GO>}

Hi. Yes, good morning.

A - Greg Lewis {BIO 20594853 <GO>}

Hey, Andrew.

A - Darius Adamczyk {BIO 18702500 <GO>}

Good morning.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Good morning.

Q - Andrew Burris Obin {BIO 6337802 <GO>}

Just a question. We're getting a lot of questions from investors on potential for global slowdown and I'm just trying to reconcile this with accelerated organic growth at Honeywell's into second half in 2019. Could you just take us around the world and just describe what you're seeing in your key geographies? Are you seeing any...

A - Darius Adamczyk {BIO 18702500 <GO>}

Sure.

Q - Andrew Burris Obin {BIO 6337802 <GO>}

...slowdown anywhere?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, no. I mean, I think, yes and no. China, for example, last year, our growth was in the 20s. Currently, we see it a little bit more kind of in the teens. I wouldn't exactly call that a slowdown. I mean, maybe relatively speaking it's a slowdown. India continues to be double-digit growth. LatAm was strong. Central Europe was strong. When I say strong, all double-digit kind of growth kind of figure.

So, overall, we're not seeing much of a slowdown. Now, you couple all that with our backlog growth, our long-cycle order growth, you couple it with some of the pass-through situations we have in Aerospace, right now I'm continuing to be bullish overall on the growth. So based on what we're seeing right now, based on the orders, long-cycle, short-cycle that we're seeing, there's every reason for me to continue to be bullish on our growth. Could that change? Of course, but I'm not seeing it right now.

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Q - Andrew Burris Obin {BIO 6337802 <GO>}

And just to follow-up on Aerospace as we're thinking about the Defense part of the business, is it just fair just to look at modernization authority growth or are there some specific programs that are driving this accelerated growth?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, it's really both. Because, as you know, our Defense business in Aerospace is really so widespread, so it's not really tied to any one given program. And whether it's tanks, aircraft, all those will drive the right financial outcomes for us and it's widespread both in the U.S. and the international arena. So as the Defense budgets grow, so will our business, and we're seeing that.

Q - Andrew Burris Obin {BIO 6337802 <GO>}

But that implies, if you look at modernization authority, it should grow like high-single digits for a while. So the business should keep up with that?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yes. I mean...

Q - Andrew Burris Obin {BIO 6337802 <GO>}

Perfect.

A - Darius Adamczyk {BIO 18702500 <GO>}

By the way, we've also expanded some capacity in Aerospace especially in the area of inertials and so on. So we've got a capacity expansion that's already taking place to keep up with that demand. And, frankly, we knew that the air transport market was going to take off. We've adjusted to that. Now, we're trying to pull the supply chain, kind of the Tier 2, Tier 3 supply chain along with that to make sure that they can keep up. And there's been a lot of energy spent on us working with our suppliers to make sure that we're ready for what we believe is the new normal.

Q - Andrew Burris Obin {BIO 6337802 <GO>}

Appreciate it. Thank you very much.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you.

Operator

And our final question will come from Steven Winoker of UBS.

Q - Steven Winoker {BIO 15988218 <GO>}

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Thanks. Good morning, all. Hey, Tom.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Hey.

Q - Steven Winoker {BIO 15988218 <GO>}

Congratulations for more than just this role. I think it's been, what, 12 years since our days at ACS? It's been a long run.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Yes. You're an insider still, Steve.

Q - Steven Winoker {BIO 15988218 <GO>}

Yeah. Well, I'll never quite leave that, tried to. You guys make me sound like a broken record on these quarters now. And the cash, particularly great to see that traction so quickly, all. Because I know that's hard. Couple questions here. One around, nobody, I think, has gone into some detail on the Q&A on PMT and HPS maybe particularly some of the dynamics there. Obviously, you have tough comps in Advanced Materials. We have oil moving steadily. So can you maybe talk about some of the dynamics and what's the potential for acceleration in HPS and UOP at least?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah. I mean, HPS performed very, very well in the second quarter. It's up mid-single digit for the first half of the year. It's such a business that's been on an absolute tear for a long time now. Our order rates are strong. We're actually even more bullish in the second half of the year. As you know, it now contains the Smart Energy business which we moved in there, which is also gaining acceleration in that as part of that management team. So, overall, we're very bullish on continued HPS performance. And overall, between HPS and UOP, kind of our quote log looks very strong for the second half and we expect to convert a lot of that to orders. So, overall, I'm very pleased with what we're seeing with PMT.

Q - Steven Winoker {BIO 15988218 <GO>}

And by the way, Darius, what is the margin rate impact these days of an implication of HPS growth? Because I know you've moved up so much over the years.

A - Darius Adamczyk {BIO 18702500 <GO>}

Can you say that again, Steve?

Q - Steven Winoker {BIO 15988218 <GO>}

So, just in terms of HPS impact on PMT segment margin as it's now growing more quickly than the rest of the segment.

A - Darius Adamczyk {BIO 18702500 <GO>}

I mean it's – it is in line with overall PMT margin rates, maybe a little bit south but it isn't accretive or dilutive materially.

Q - Steven Winoker {BIO 15988218 <GO>}

And do you still see margin expansion opportunity in that segment?

A - Thomas A. Szlosek {BIO 6474485 <GO>}

For sure.

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, absolutely. Especially, I think the team is doing a tremendous job in further driving Productivity and Smart Energy. I mean, they – the HPS team really knows how to drive Productivity well. The Smart Energy business, frankly, has an opportunity to do a lot of that. It's a projects business, a software business, both areas that are very, very comfortable for HPS. And as you know, in the second half of last year, they've taking the business on and are already seeing progress and there is much more to come. So, they're far from done in terms of margin expansion in HPS.

A - Thomas A. Szlosek {BIO 6474485 <GO>}

Yeah. And it's one of our more mature, I'd say, Connected enterprises in terms of that software offering. So, absolutely have a nice tailwind there on margins, Steve.

Q - Steven Winoker {BIO 15988218 <GO>}

Okay. And just lastly, on page seven, that's really helpful in terms of the tariff/inflation comment. But we're hearing a lot about pricing from other companies. How much of your offset is a really pricing action playing into this, or there are really just a lot of other things going on?

A - Greg Lewis {BIO 20594853 <GO>}

Yeah. We're doing a mix of both pricing and some sourcing changes as well as we're benefiting from having locked in some purchases earlier in the year. So, of our mitigations, I would say, it's probably two-thirds, one-third in terms of pricing versus our sourcing actions. But so far, we've had success passing through where appropriate. And as I discussed, we're – these things changes by the day and this is – in fact, this is a weekly cadence we have going on across the entire enterprise, so not much grass is growing under our feet as this is changing.

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah. Just to add to that, it's – I think the key here is to get ahead of it early and I think we definitely have. And then, we haven't lost focus. This is literally a weekly activity for us and probably the single most important thing that we talk about in making sure that we're proactive, we're being ahead of here because if you sit and wait, you could see the substantial margin contraction. So, we're doing a good job managing, but there's still a lot of unknowns here we don't know that we're planning for.

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A - Greg Lewis {BIO 20594853 <GO>}

Yeah. And we're – I mean, we're benefiting from the fact that we do have a lot of local-for-local business constructs so that's been helpful to us. And in fact, there's going to be some places where us sourcing from non-China sources are going to be competitively helpful where others are sourcing from China. So, it's a complex equation, there's obviously the sourcing challenges, but there are also some places where it could be competitively advantageous to us as well. So, we're trying to make a good balance.

A - Darius Adamczyk {BIO 18702500 <GO>}

And just to highlight that point that Greg just made which is, we have a structure for the most part – not perfectly – but we're kind of regionally hub-oriented. So to say, we have kind of a local-for-local sourcing, engineering, marketing, supply chain base. So, we're – I wouldn't tell you we're not impacted but we're a lot more prepared because of our global footprint and how we operate the business.

Q - Steven Winoker {BIO 15988218 <GO>}

Thanks. Great color. Thanks, all. And good luck, I'll see you soon.

A - Greg Lewis {BIO 20594853 <GO>}

Thanks, Steve.

A - Darius Adamczyk {BIO 18702500 <GO>}

Steve, thank you.

Operator

And this does conclude today's question and answer session. At this time I'd like to turn the conference back to Mr. Darius Adamczyk for any additional closing remarks.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you. I have full confidence that the strong performance we delivered for our shareowners in the first and second quarters will continue throughout the rest of the year. Our order rates are strong, our backlogs are growing and we're realizing the benefits from our continued efforts to drive software and Connected growth, productivity, commercial excellence, and improved free cash flow. Honeywell is well-positioned to continue to deliver and I hope that is evident in both the second quarter performance and the commitments we made to you today.

Before we end, I want to take a minute to thank Tom Szlosek for all his contributions to the company. Tom has gracefully navigated the businesses and the finance organization through some pretty significant changes and challenges over the past four years. It has been a pleasure to have Tom on my staff and at the company for the past 14 years and we wish him all the best in the future. Congratulations on a successful career, Tom.

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A - Thomas A. Szlosek {BIO 6474485 <GO>}

Thank you.

A - Darius Adamczyk {BIO 18702500 <GO>}

On behalf of the entire Honeywell team, I wish you a pleasant rest of the summer. Thank you.

Operator

Thank you. This does conclude today's teleconference. Please disconnect your lines at this time and have a wonderful day.

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