Company Name: Honeywell
Company Ticker: HON US
Date: 2018-07-20
Event Description: Q2 2018 Earnings Call

Market Cap: 113,715.95
Current PX: 153.13
YTD Change($): -.23
YTD Change(%): -.150

Bloomberg Estimates - EPS
Current Quarter: 1.966
Current Year: 8.053
Bloomberg Estimates - Sales
Current Quarter: 10671.857
Current Year: 43184.176

Q2 2018 Earnings Call

Company Participants

- Mark Macaluso
- Darius Adamczyk
- Thomas A. Szlosek
- Greg Lewis

Other Participants

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

MANAGEMENT DISCUSSION SECTION

Mark Macaluso

Non-GAAP Financial Measures

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

Darius Adamczyk

Business Highlights

EPS and Tax Rate

- Honeywell delivered another outstanding quarter of EPS of $2.12, up 18% y-over-y exceeding the high-end of our guidance range
- Using our effective tax rate guidance for the quarter of 24%, EPS was $2.06, or $0.03 above the high end of our guidance range
- Tom will take you through these details momentarily

Organic Sales Growth

- 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 H2 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

Operational Performance

- We expanded segment margin by 60BPS, 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

HOS Gold Working Capital

- FCF was again a highlight this quarter at about $1.7B, up 42% y-over-y 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 Q1 as our HOS Gold working capital toolset continues to deliver results
- Finally, we continued to aggressively deploy capital, repurchasing about $800mm in Honeywell shares

Share Repurchasing

- In total, in H1, we repurchased about $1.7B 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 $4B of cash being repatriated in 2018
  - We brought back nearly $2.2B into the U.S. through Q2

Segment Margin Expansion, EPS and FCF

- 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 40BPS to 60BPS
  - Our EPS guidance to a new range of $8.05 to $8.15, or up 13% to 15%
  - And our full year FCF guidance to $5.6B to $6.2B.
- 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 H2

Aerospace

- 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

- 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

Connected Aircraft

- The study found that about half of the respondents expect to spend up to $1mm per aircraft on connectivity technologies over the next year and 17% of respondents expect to spend more than $10mm 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

Home and Building Technologies

- 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

Performance Materials and Technologies

- 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

HUG

- 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

Safety and Productivity Solution

- Finally, in Safety and Productivity Solutions, Honeywell Intelligrated provided the material handling equipment design, installation, and support for Amazon's new more than 0.5mm 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

Intelligrated System

- 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

Connected Offerings

- 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

Thomas A. Szlosek

Financial Highlights

Organic Growth

- 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

U.S. Dollar

- 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 H1 compared to 2017
- For example, the euro averaged about $1.20 in Q2 2018, vs. about $1.10 in 2017

Segment Profit and EPS

- Segment profit was up 12% in the quarter and segment margin expanded by 60BPS to 19.6%, primarily due to the benefits from higher sales volumes, commercial excellence and material productivity
- EPS of $2.12, up 18%, and exceeded the high-end of our guidance range by $0.09
  - This excludes spin-related separation costs of $346mm in the quarter
- We'll walk you through the details of the EPS shortly

FCF

- FCF in Q2 $1.7B, 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 $800mm of Honeywell shares bringing our YTD share repurchases to about $1.7B

Growth Investments

- 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 H2
- Overall, strong performance across the board

Earnings Growth

- Slide 5 walks our EPS from Q2 2017 to Q2 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

Tailwind

- Below the line items were $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 $60mm in high-return restructuring projects

Share Repurchasing

- The share repurchase actions in Q2 resulted in a lower weighted average share count of 755mm shares
- Combined with the slightly higher earnings attributable to non-controlling interests, the share repurchases were $0.04 tailwind to EPS

Tax Rate

- We had planned and guided our tax rate at 24% for the quarter, compared to 21.3% last year, which would have resulted in $0.07 headwind to EPS
- At this higher 24% planned tax rate, our EPS 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% vs. 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 y-over-y basis then, the actual tax rate for Q2 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 EPS

U.S. Tax Legislation

- 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 Q4 2017 relating to the U.S. tax legislation, as well as separation costs associated with the two spinoffs

Separation Costs

- In Q2, we incurred $346mm or $0.46 of separation costs, $291mm 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 Q4 U.S. tax legislation charge were $0.02 benefit to EPS
  - So netting out the two items resulted in $0.44 change in reported EPS to $1.68

Aerospace Business

- 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

Commercial OE

- 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

- 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% YTD driven by demand for our GoDirect Cabin software

Transportation Systems

- 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 30BPS driven by higher sales volumes, commercial excellence, and lower y-over-y customer incentives
- In the quarter, there was a 30-basis-point headwind from foreign currency primarily in Transportation Systems business

Home and Building Technologies

- 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 Q1, sales grew across all regions in ADI

Buildings

- In Buildings, organic sales were flat y-over-y

- 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 60BPS driven by commercial excellence, the benefits from previously funded and executed restructuring, and higher sales volumes

Performance Materials and Technologies

- 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 H2

Advanced Materials

- 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 50BPS 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

Safety and Productivity Solutions

- 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 vs. the competition in the marketplace

Organic Growth

- 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 150BPS enabled by higher sales volumes, commercial excellence, and benefits from previously funded and executed restructuring
  - We're extremely pleased with SPS' performance this quarter

Executive Appointment

- Greg is now going to cover our outlook for Q3 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

Greg Lewis

Q2 Highlights

Tariffs

- 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 $50B of goods affected by Section 301, as well as the retaliatory offsets, and are currently assessing the potential additional $200B of targeted tariffs

Procurement, Marketing and Commercial Excellence Team

- 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

Accomplishments

- 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

Transportation Systems and Homes

- 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 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

Debt and Equity

- 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

Tax Charge and U.S. Tax Reform

- 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 Q4 2017 related to U.S. tax reform
- We had a minor favorable adjustment to the charge in Q2
    - These favorable adjustments may be larger in H2 and we'll provide you with updates as we move forward

Outlook

Order Rate, Volume and Tax Rate

- Now, let's move to slide 8 and we'll discuss our outlook for Q3
- 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 30BPS to 50BPS, driven by those increased volumes, commercial excellence and material productivity, similar to what we saw in Q2
- We anticipated third quarter EPS of $1.95 to $2 or growth of 11% to 14% with a tax rate of approximately 22%

Aerospace

- 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

Aftermarket

- 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

Defense and Space

- 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

Home and Building Technologies

- 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 H1
- Within Homes, we anticipate continued growth in products, driven by demand for thermostats and residential thermal solutions and continued strength in ADI

Performance Materials and Technologies

- On Performance Materials and Technologies, we are anticipating healthy growth in each of our businesses in Q3

- 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 H1 short-cycle orders growth

Advanced Materials

- 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

UOP

- 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 H2, we do expect that PMT margins will be down in Q3 but those margin rates will significantly increase in Q4
  - Those quarter-to-quarter dynamics are not unusual in this business and I believe we've talked about them before

Safety and Productivity Solutions

- Finally, in Safety and Productivity Solutions, we expect continued outperformance in Intelligrated, driven by strong orders growth and project backlog awarded in H1 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

Guidance

Sales, Segment Margin, EPS and FCF

- Now, moving to slide 9 to discuss our full year guidance
- As Darius mentioned, we've raised our full year sales, segment margin, EPS, and FCF guidance to reflect our strong performance in Q2 and confidence in our outlook for H2 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

Organic Sales

- 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 40BPS to 60BPS, the high-end of our prior range, which reflects our strong H1 and confidence in strong sales volumes in H2

FCF

- We've significantly increased our FCF guidance to a new range of $5.6B to $6.2B driven by higher net income and better working capital performance across the business as you've seen in Q2
- This new range implies conversion of 92% to 100% a strong improvement from the 90% we posted in 2017

Tax Rate

- 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 754mm shares which includes the $1.7B in share repurchases in H1 and an estimate of the repurchases planned for the remainder of 2018
- We anticipate this will provide $0.03 benefit to EPS in H2 vs. our previous guide

Home and Building Technologies

- On a segment level, we now expect Aerospace organic sales growth to be 7% to 8% vs. 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 10BPS to 30BPS to 50BPS 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 H2

Safety and Productivity Solutions

- In Safety and Productivity Solutions we have increased our organic sales growth expectations to 7% to 8% vs. 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 90BPS to 110BPS 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 H2

Operational Performance

- So, let's wrap up on slide 10

- Honeywell delivered outstanding operational performance in Q2 with 6% organic sales growth, 60BPS of margin expansion, 18% earnings growth, and 42% FCF growth
- On top of our financial performance, we've continue to make significant progress in becoming a software-industrial leader

Connected Offerings

- Our Connected offerings are helping our customers solve critical challenges across our large installed base
- We expect the momentum we have seen in H1 to continue into H2
- Our orders rates remain strong and our backlog continues to grow

Transportation Systems and Homes Business

- 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

QUESTION AND ANSWER SECTION

<Q - Joe Ritchie>: 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>: Thanks, Joe.

<A - Greg Lewis>: Thank you, Joe.

<Q - Joe Ritchie>: 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?

<A - Darius Adamczyk>: 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 H2 based on the activity of our pipeline.

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>: 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>: 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>: 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 FCF side?

<A - Darius Adamczyk>: 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>: 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 vs. 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 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 - Scott Reed Davis>: 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>: Thanks, Scott. Thank you.

<A - Greg Lewis>: Thank you.

<Q - Scott Reed Davis>: 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>: 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>: 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>: Yeah, it's north of $1.5B. It's purely the Connected revenues. That's not the total software business, just to be clear.

<Q - Scott Reed Davis>: Yeah, understood. And I imagine that strong FCF as well probably, right?

<A - Darius Adamczyk>: Absolutely.

<Q - Charles Stephen Tusa>: 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 FCF, 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>: 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.

<Q - Charles Stephen Tusa>: And then, you guys – I believe you bought back another $700mm 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>: 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>: 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>: 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>: And we talked about, at the beginning of the year, of having capital deployed of $5B to $6B 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 FCF, I think we'll have more opportunity.

<A - Darius Adamczyk>: 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 $3B mark for the two spins, I'm going to have to use some of that to pay down debt, something in the $1B to $2B 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.

<Q - Charles Stephen Tusa>: No, it's clear. Having more cabbage is better than not having any cabbage. That's very clear. Thanks, guys.

<Q - Jeffrey Todd Sprague>: 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>: Exactly.

<Q - Jeffrey Todd Sprague>: So now that we're...

<A - Darius Adamczyk>: Glad that you asked.

<Q - Jeffrey Todd Sprague>: ...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>: 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 $113mm, $114mm 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.

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>: 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 H2 event.

<A - Greg Lewis>: Yeah. No slippage. We are going according to plan. I think we talked about the end of Q3 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 - Julian Mitchell>: 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>: 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.

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 vs. mechanical focus vs. 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>: 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>: 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>: Yeah.

<Q - Julian Mitchell>: And are you seeing much better margins on large projects perhaps that you might have done historically?

<A - Darius Adamczyk>: 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>: 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 - Deane Dray>: 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>: 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 vs. 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 H2 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>: 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>: 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 H2, 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 - Andrew Burris Obin>: 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 H2 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>: Sure.

<Q - Andrew Burris Obin>: ...slowdown anywhere?

<A - Darius Adamczyk>: 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.

<Q - Andrew Burris Obin>: 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>: 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>: 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>: Yes. I mean...

<Q - Andrew Burris Obin>: Perfect.

<A - Darius Adamczyk>: 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 - Steven Winoker>: 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>: Yes. You're an insider still, Steve.

<Q - Steven Winoker>: 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>: Yeah. I mean, HPS performed very, very well in Q2. It's up mid-single digit for H1. 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 H2. 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 H2 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>: 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>: Can you say that again, Steve?

<Q - Steven Winoker>: 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>: 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>: And do you still see margin expansion opportunity in that segment?

<A - Thomas A. Szlosek>: For sure.

<A - Darius Adamczyk>: 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 H2 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>: 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>: 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>: 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 vs. 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>: 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.

<A - Greg Lewis>: 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>: 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.

Darius Adamczyk

Q2 Highlights

Order Rate, Backlog and FCF

- 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 FCF
- Honeywell is well-positioned to continue to deliver and I hope that is evident in both Q2 performance and the commitments we made to you today

Closing Remarks

- 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.