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Ingersoll-Rand Plc (IR) CEO Mike Lamach on Q3 2019 Results- Earnings Call Transcript

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Q3: 10-29-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $1.99 beats by $0.08 | Revenue of $4.34B (7.77% Y/Y) beats by $48.26M

Earning Call Audio

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Ingersoll-Rand Plc (NYSE:IR) Q3 2019 Earnings Conference Call October 29, 2019 10:00 AM ET

Company Participants

Zac Nagle - VP, IR

Mike Lamach - Chairman and CEO

Sue Carter - SVP and CFO

Conference Call Participants

Steve Tusa - JPMorgan

Jeff Sprague - Vertical Research

Scott Davis - Melius Research

Julian Mitchell - Barclays

Nigel Coe - Wolfe Research

John Walsh - Credit Suisse

Andrew Obin - Bank of America Merrill Lynch

Nicole DeBlase - Deutsche Bank

Josh Pokrzywinski - Morgan Stanley

Operator

Good morning, ladies and gentlemen, thank you for standing by. Welcome to the Ingersoll Rand Third Quarter 2019 Earnings Conference Call. My name is Denise, and I'll be your conference operator today. [Operator Instructions]

I would now like to hand the conference over to Zac Nagle, Vice President of Investor Relations. Please begin.

Zac Nagle

Thanks, Operator. Good morning, and thank you for joining us for Ingersoll Rand's third quarter 2019 earnings conference call. This call is being webcast on our website ingersollrand.com where you'll find the accompanying presentation. We are also recording and archiving this call on our website.

Please go to Slide 2. Statements made in today's call that are not historical facts are considered forward-looking statements and are made pursuant to the Safe Harbor provisions of federal securities law. Please see our SEC filings for a description of some of the factors that may cause our actual results to differ materially from anticipated results. This presentation also includes non-GAAP measures, which are explained in the financial tables attached to our news release.

Joining me on today's call are Mike Lamach, Chairman and CEO; and Sue Carter, Senior Vice President and CFO. With that, please go to Slide 3, and I'll turn the call over to Mike. Mike?

Mike Lamach

Thanks, Zach and thanks everyone for joining us on the call today.

I'd like to start out today's call with a brief overview of our global business strategy that's enabling us to consistently deliver strong financial results for our shareholders. Fundamentally, our strategy as the nexus of environmental sustainability and impact, which are strong secular tailwinds for our business. The world is continuing to urbanize, while becoming warmer and more resource constrained as time passes.

At our core, we are focused on and excel at reducing the energy intensity in buildings, reducing greenhouse gas emissions, reducing waste of food and other perishable goods and we excel in our ability to generate productivity for our customers all enabled by technology. Unless you think the world is getting cooler, less populated, and less resource constrained as time passes, these strong secular tailwinds will continue to provide opportunity for shareholders and purpose for our vision.

As we continue separation, integration planning activities related to the combination of our Industrial segment with Gardner, Denver and transformation activities related to our move towards creating the premier pure-play climate business in 2020, our aggressive pursuit of excellence in driving solutions to mitigate the impact of these secular trends only intensifies.

Our Climate businesses squarely focused 100% of our portfolio at the nexus of sustainability and global environmental impact, where our products and services can reduce the impact of these megatrends and further advance the platform for the company to grow above average global economic conditions.

Moving to Slide 4, we continue to deliver strong financial results by effectively managing through an evolving global landscape. In the third quarter, we delivered 6% organic revenue growth and 14% adjusted EPS growth, compounding on tough comps of 10% organic revenue growth and 22% adjusted EPS growth in the 3rd quarter of 2018.

We remain bullish on our strategy, the opportunities that lie ahead in our end markets broadly and particularly, and our team's resilience and their ability to execute, using our business operating system to deliver against the top tier organic revenue growth and adjusted EPS guidance targets we provided for fiscal 2019.

We continue to deliver strong and differentiated performance in Q3 in our Climate segment globally. Climate segment organic revenues were up 8% against a tough comp of 2018. Our global HVAC business performance was particularly strong, with approximately 10% organic bookings growth and approximately 10% organic revenue growth. Our performance was also broad based with North American commercial HVAC, European commercial HVAC, and residential HVAC, all significantly to contributing to the growth.

Our backlog pipeline and order rates continue to be solid and support healthy growth in the fourth quarter. This is reflected in our revised full year Climate segment organic growth guidance of 7% to 7.5% revenue growth, which is a four point above the top of the prior guidance range.

Delivering strong climate performance has enabled us to effectively offset persistent softness and global short cycle industrial spending, which drove organic revenue declines in our short cycle industrial businesses, mainly in compression technologies and tools.

In 2019 long cycle larger compressor orders are shown more resiliency and small to mid size short cycle compressors and we're building a solid backlog for these products year-over-year. However, the majority of these units won't ship or deliver meaningful revenues until 2020 and 2021.

Despite revenue declines in our high gross margin compression Technologies business, the steps we've taken to restructure and fundamentally improve our operations and service mix over the past several years, enabled us to manage the leverage of the business within our gross margin target rate, demonstrating what we believe is a more resilient business, better able to weather economic downturns.

In transport, we delivered low single-digit revenue growth in the quarter against the tough comp in 2018. We also expect revenues to moderate some in the second half versus the first half, again comparing a tough comps in the second half of 2018.

Further softening of the European economy combined with ongoing Brexit uncertainty, has softened our European trailer outlook for the back half of the year for the region. But we expect this to be largely offset by strong North American revenues for 2019.

Our outlook for mid single-digit organic revenue growth in 2019 for our overall transport business remains unchanged. We continue to effectively manage tariff and inflationary headwinds and deliver a positive price versus material cost spread.

Volume and productivity are also strong nailing us to drive solid margin expansion. As always delivering strong free cash flow and directing capital deployment towards high ROI projects remains core priorities.

Lastly, we're excited about the pending Reverse Morris Trust transaction with Gardner Denver, creating a premier industrial company, while simultaneously creating a leading pure-play Climate Technologies company, focused on HVAC and transport refrigeration. We believe both businesses have potential to unlock value for shareholders.

Please go to Slide 5. This slide provides a visual depiction of organic bookings and revenue growth in the third quarter. As I discussed on the prior slide, we delivered strong broad based bookings in revenue growth in virtually all businesses and regions and our Climate segment in the third quarter, and the business was up approximately 10% in organic bookings, excluding transport and up 8% overall in organic revenues.

Asia continues to see the impacts of trade tensions and broader economic uncertainty, remains a stable market. Commercial HVAC Asia, organic bookings were up mid single digits in the third quarter. Climate Asia organic revenues were down mid-single digits against the tough low teens revenue comp in China in the third quarter of 2018.

As I outlined on the prior slide, our Compression Technologies industrial products businesses continued to be impacted by the slowing industrial short cycle spending. Our small electric vehicle business has continued to deliver strong growth, driven largely by our consumer vehicle strategy. All in, industrial organic bookings and revenues were essentially flat in the quarter.

Please turn to Slide 6. We've encapsulated number of takeaways for our major end markets on this slide for your reference. I've covered much of this content already, so I'll just add a few brief comments before passing the call along to Sue.

First focused execution of our business strategy is enabling us to continue to deliver a very strong global HVAC performance, particularly in North America, Europe, and then the residential business. Our end markets are largely healthy, and we believe we are outperforming the underlying growth rates in these markets.

The transport market has softened a bit versus our view when we exited the second quarter, primarily really driven by the softening of the European market, which continues to be impacted by weakening economic fundamentals and uncertainty surrounding Brexit.

Overall, we believe focused execution of our strategy is enabling us to outperform global transport market conditions and we are on track to deliver mid single-digit growth in transport for 2019.

Lastly, have talked at length about slowing industrial short cycle spending impacting our quicker book and ship small and mid-sized air compressors, industrial products businesses. We expect this softness to continue through the fourth quarter, consistent with our updated 2019 guidance. And we expect to offset the softness with the strength we're seeing in global HVAC.

And now I'd like to turn the call over to Sue to provide more details on the quarter. Sue?

Sue Carter

Thank you, Mike.

Please go to Slide 7. I'll begin with a summary of a few main points to take away from today's call. As Mike discussed, we delivered strong financial results in the third quarter with adjusted earnings per share of $1.99, an increase of 14% versus the year ago period, driven by strong performance in our climate segment. We continue to execute well in an evolving global landscape and remain on track to deliver against our full-year organic revenue growth, EPS growth, and margin guidance.

Third quarter organic revenue growth was strong, particularly in our climate segment. Orders were also strong in our climate segment. When excluding our transport business that saw outsized order growth in 2018, organic bookings were up high single digits for the enterprise and approximately 10% for our Climate segment.

In our Industrial segment organic revenues were flat versus a tough year-over-year comp of 9% organic revenue growth in the prior year. Strong revenue growth in small electric vehicles largely offset the softness in the industrial short cycle markets, we mentioned previously.

During Q3, we expanded adjusted operating margin 70 basis points and delivered 25% operating leverage consistent with our full year expectations. We continue to leverage our business operating system across the enterprise to manage direct material, tariff related, and other inflationary headwinds.

As we look to the fourth quarter, we will continue to leverage our business operating system to drive further margin expansion. As Mike mentioned, we continue to expect strong free cash flow in 2019 of equal to or greater than 100% of net income. Through Q3, we have delivered approximately $1 billion in free cash flow and are on track to hit our full year expectations.

Importantly, we continue to deliver on our balanced capital allocation strategy. During Q3, we deployed approximately $124 million in dividends and approximately $250 million on share buybacks. Looking forward, we expect to consistently deploy 100% of excess cash over time.

Please go to Slide 8. Taking a step back from the details for a moment, Q3 was a very strong quarter with top quartile performance. We delivered organic revenue growth of 6%, adjusted operating margin improvement of 70 basis points and adjusted earnings per share growth of 14%.

Organic revenue growth was driven by global HVAC strength in our Climate segment, continued disciplined focus on pricing and productivity actions enabled us to effectively manage inflation and tariff related headwinds and drive margin expansion across the enterprise.

Please go to Slide 9. Our Climate segment delivered another strong quarter of operating income growth, enabling us to drive solid year-over-year EPS growth in the quarter. Our Industrial segment delivered $0.05 of EPS growth with solid small electric vehicles growth and the addition of our Precision Flow Systems acquisition that we closed in Q2, more than offsetting revenue declines in other industrial businesses.

In addition to good segment performance, third quarter corporate costs were lower than prior year, due to ongoing cost management activities, lower stock-based and incentive compensation and the timing of unallocated corporate spending. We now expect our full year corporate cost to be less than $240 million, down from our previous guidance of approximately $250 million.

Please go to Slide 10. In Q3 strong execution drove 70 basis points of adjusted operating margin improvement on strong price versus material inflation and productivity versus other inflation spreads.

During the second half of 2019, we are lapping strong pricing implemented in the back half of 2018. Consistent with our expectations, we delivered 40 basis points of margin expansion from price versus material inflation. This represents our sixth consecutive quarter of positive price cost.

We delivered solid margin expansion from volume growth in the quarter. Margin expansion was tempered by mix pressure as we delivered outsized growth from commercial HVAC applied systems, as compared to other initially higher margin products like unitary or transport equipment. Over 20 to 30 year life an applied system carries high margin service and aftermarket parts, but the initial sale creates pressure on margin mix.

Additionally, consistent with last quarter, we saw a mix pressure from softness in short cycle industrial revenue which also tend to have high margins. Productivity versus other inflation across the enterprise improved margins by 80 basis points in the quarter.

In both our Climate and Industrial segments, we delivered strong productivity from operational excellence and restructuring savings. Reduced corporate costs also contributed to the margin expansion. We continue to invest heavily in growth and operating expense reduction projects with high returns on investment. Incremental Q3 investments totaled approximately 30 basis points.

Please go to Slide 11. Our Climate segment delivered another strong quarter with 8% organic revenue growth and adjusted operating margin expansion of 30 basis points. Consistent with our expectations, we delivered strong volume growth, price realization, and productivity.

Please go to Slide 12. In our Industrial segment organic revenues were flat against tough comps of 9% organic growth in the prior year. Strong revenue growth in small electric vehicles largely offset softness in the industrial short cycle markets.

Over the past several years, we have built a stronger more resilient industrial business. In our Compression Technologies business. for example, pricing. productivity, and restructuring savings partially offset volume declines to enable deleverage within gross margin rates for the second quarter in a row.

Industrial segment adjusted operating margins expanded 40 basis points in the quarter. Our high EBITDA margin PFS acquisition continues to improve our Industrial EBITDA margins. We expanded adjusted EBITDA margins 110 basis points in the quarter.

Please go to Slide 13. We remain committed to a dynamic capital allocation strategy that consistently deploys excess cash to the opportunities with the highest returns for shareholders. We maintain a healthy level of business investments in high ROI technology, innovation and operational excellence projects, which are vital to our continued growth, product leadership, and margin expansion. We continue to make strategic investments in acquisitions that further improve long-term shareholder returns.

We remain committed to maintaining a strong balance sheet that provides us with continued optionality as our markets evolve. We have a longstanding commitment to a reliable, strong and growing dividend that increases at or above the rate of earnings growth over time.

With the proposed transaction with Gardner Denver growing closer, I'd like to highlight that we expect to maintain our annualized dividend of $2.12 per share post closing and through 2020.

This will deliver a very attractive dividend yield for the new Climate core. For 2021 and beyond, we will evaluate dividend increases in line with earnings growth, consistent with our longstanding capital deployment priorities. We continue to see value in share repurchases and we expect to consistently deploy 100% excess cash over time.

Please go to Slide 15. When we are on the road, we often get questions about the status of the proposed transaction to combine our Industrial segment with Gardner Denver. We continue to be excited about the prospects of creating a premier industrial company, as well as a leading pure-play Climate Technologies company focused on HVAC and transport refrigeration. I'll give you a brief update today.

First, the transaction with Gardner Denver remains on track for deal closure in early 2020. In reviewing our priorities between now and deal closure, our first priority is and will continue to be, running the business and taking care of our customers.

To maintain focus on our customers, we have dedicated teams carrying out separation and integration planning, as well as Climate core transformation activities. Separation activities encompass separation of technical and financial operating processes and systems, manufacturing operations, and supply chain services, and real estate, along with all business regulatory filings.

We have a detailed project plan and we are executing against that plan. When necessary, we are creating transition services agreements to support day one operations for certain processes and services.

At this stage, we anticipate one time separation and transaction related costs to be at the high-end of our previously communicated range of approximately $150 million to $200 million. Given that we in Gardner Denver continue to operate as two separate companies and compete in the marketplace until the close of the transaction. The integration planning work must be managed under clear rules and antitrust protocols.

We will continue to work within these rules as we progress towards day one of the new industrial business. Additionally, we expect to leverage this opportunity to further improve our Climate business to better serve our customers and unlock value for shareholders with a singular focus on reducing the world's energy intensity and greenhouse gas emissions. We are building on an incredibly strong foundation with great businesses, engaged and talented people, and a distinctive winning culture, and core values.

As I said at the beginning, we remain excited about the prospects of creating a premier industrial company, as well as a leading pure-play Climate Technologies Company. On another note, given the outsize transport order growth in 2018, we often get questions on the road about our order outlook. As we look at the fourth quarter. I'll remind you that we booked a large commercial order worth approximately $200 million in Q4 of last year.

As we discussed when we booked this order, the revenues are expected to be recognized over the course of approximately 3.5 years. Excluding this large order, we have tough comps in the rest of the business where enterprise organic bookings were up approximately 11% and Climate segment organic bookings were up approximately 13%.

Please go to Slide 16. As we highlighted earlier, we continue to execute well in an evolving landscape. All in our full year adjusted earnings per share guidance remains unchanged at approximately $6.40. Our enterprise revenues and margin guidance also remains unchanged.

With our continued strong Climate segment revenue growth led by global HVAC, we now anticipate full year organic revenues to grow between approximately 7% and 7.5%, a four point higher than our original guidance.

Our Industrial segment revenues have been impacted by soft short cycle investment spending. We now anticipate Industrial organic revenue to be flat to up 0.5% for the year, as we expect short cycle softness to persist in the fourth quarter.

Our guidance for both our Climate segment and our Industrial segment margin rates remain unchanged, although we do anticipate delivering towards the high-end of the Climate range and towards the low-end of the Industrial range.

We are increasing full-year restructuring cost guidance to approximately $0.30 from $0.25 primarily related to additional footprint optimization efforts. We have a couple of elements of guidance, we also recommend tweaking including reduced corporate spending to less than $240 million and a lower expected effective tax rate of approximately 20% to 21%.

And with that, I'll turn the call back over to Mike.

Mike Lamach

Thanks Sue.

Please go to Slide 17. In summary, we're effectively managing the global landscape, as it evolves to deliver our 2019 guidance for top tier revenue growth, EPS growth, and free cash flow in 2019. Looking forward, we believe the company is extremely well positioned to deliver strong shareholder returns over the next several years.

Fundamentally, our strategy remains at the nexus of environmental sustainability and impact. Today 15% of the world's carbon emissions come from heating and cooling buildings and by 2030, it's estimated that 25% will derive from these sources. Transport, refrigeration creates another 80 million metric tons of Co2 emissions annually, which can be eliminated through electrification over time.

Earlier this year, we announced our 2030 ESG commitments, which included a commitment to reduce our customer carbon footprint by one gigaton of Co2, through our HVAC and transport refrigeration products and services.

We believe this is the largest Customer Climate commitment made by any B2B company, and our math shows that this reduction could equate to 2% of the world's total emissions. Besides the scale, it's equivalent to the annual emissions of Italy, France, and the U.K. combined.

At the Climate Summit last month, we also introduced the same challenge to like-minded companies. We are bending the global warming curve by changing the way the world heats and cools buildings and moves refrigerated cargo. New technology, we've developed can reduce up to 99% of the emissions that come from heating and cooling a commercial building and this doesn't include the substantial environmental benefit of increasing system energy efficiency, through optimized system designs, advanced controls, and data analytics. Ongoing system monitoring, and service and maintenance.

These comprehensive solutions can also dramatically reduce power generation at the source energy storage requirements. We're continually working to innovate in this way to electrify heating, electrify diesel engines used to cool trucks and trailers that transport perishable goods, and to reduce the energy intensity and greenhouse gas emissions in residential and commercial buildings.

Our 2030 ESG commitments also included addressing a host of other important issues. We continue to transform our supply chain and operations to have a restorative impact on the environment including achieving carbon-neutral operations and giving back more water than we use in water-stressed areas. We are committed to increasing opportunity for all, strengthening economic mobility, and bolstering the quality of life of our people.

Additionally, we are committed to gender parity and leadership roles. The workforce reflective of our community populations, maintaining a livable market competitive wages, and broadening community access to cooling comfort and healthy foods. We've been investing heavily for years to build franchise brands and to advance our leadership market positions to enable consistent profitable growth. We have an experienced management team and a high performing culture that instills operational excellence into everything we do.

We remain committed to dynamic and balanced deployment of capital and we have a strong track record of deploying excess cash to deliver top-tier shareholder returns over the years. Lastly, we're extremely excited about the proposed transaction and the strategic combination of our industrial segment with Gardner Denver.

Combining two of the premier complementary industrial companies, offers the opportunity to drive significant innovation and growth with meaningful revenue and cost synergies supported by secular growth trends and diverse end market exposure.

We're also excited about creating the premier pure-play HVAC and transport refrigeration company, with our existing Climate segment businesses. We have a tremendous opportunity to leverage a simplified business model and design, and sharpen our sustainability focus in our investments.

Our Climate businesses have clearly differentiated performance and we see significant opportunity as a pure-play to building this performance for our employees, customers, and shareholders.

And with that, Sue and I will be happy to take your questions. Operator?

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from Steve Tusa with JPMorgan. Your line is open.

Steve Tusa

I don't unusually suck up on these calls, but congrats to you guys for not getting over year ski dips after a good first half and staying conservative. It obviously is warranted in this environment. So kudos to you guys for that. On the businesses, resi, you're saying contributed to kind of orders and revenue growth. So that means there was kind of revenues up greater than a high single-digit and orders up around double digit. Is that kind of the messaging there on resi?

Mike Lamach

The resi was strong Steve, I agree with what you said. We typically don't think about residential bookings, because residential bookings turn so quickly, but we did on in the quarter with a low teens booking number. So to the extent you can read a little forward in the fourth quarter. I feel it's going to be fairly strong again.

Sue Carter

I'm going to also say, Steve, as you think about that our residential business in addition to having good revenues in the third quarter also had some tough comparisons to the third quarter of last year, where the revenues were also very high.

Steve Tusa

Clearly you guys are taking some of this year that was lost by Lanex. What are the mechanics of kind of holding on to those customers. And is that - do you feel like that's now yours to lose or is they kind of try and come back after that there is a risk that that fades?

Mike Lamach

Steve, I'll just say we're just executing our own strategy here. So this is building great stuff, having great distribution, working through all the technical and digital work that we've been working on now for a couple of years. So this is just really us executing against our own strategy more than it is anything else.

Steve Tusa

And then just a quick one on the details on the productivity and other on inflation. Even ex - the corporate kind of benefits there, it looks pretty solid, like up 50 basis points. To me it was up 80 basis points reported. Anything specific to call out there and is that kind of the benefits of recent restructuring and is that something that you guys can pull lever on into - in the future if things get a little bit weaker on your revenues?

Mike Lamach

I'll let Sue come here in a second. Steve, one thing I'd say would be on the corporate side, we worked really hard at reducing corporate cost and thought about this over the past year and a half 2 years now and putting the same lean tools toward benchmarking and executing against cost reductions there. So I'm happy to see that that's actually flowing through. And then Sue do you have any other comments?

Sue Carter

Yes, I think when you think about the productivity in general, Steve, you're absolutely right. Some of the productivity in operations comes from normal productivity projects that we have on any given year, but it also comes from some of the restructuring that we've done over the past couple of years.

And on the corporate side to Mike's point, we worked really hard at decreasing the functional spending over time. We know we've been successful at that, in that we've leveled down to spending as well as have offset any inflation that comes into the corporate arena. And just in case anyone is thinking about the less than $240 million.

The fourth quarter is when all have different accruals and other things get trued up, so we didn't want to get ahead of ourselves on what that look like. But all in all, a really good productivity quarter for the entire company.

Operator

Your next question comes from Jeff Sprague with Vertical Research. Your line is open.

Jeff Sprague

Maybe to pick up on that thread a little bit, should we view what we're seeing in corporate costs here kind of a running start on the stranded costs? And could you update us on what your view there is? And how that should play out maybe over the next couple of quarters?

Mike Lamach

Yes, we - Jeff, we've done a lot of work on the blueprinting to this point, about where we think the opportunity is for all of Climate across the - all the Climate - I'm sorry, all the cost structure, whether that be at corporate or what's in the segments. Also rethinking what should be in corporate and what should be in the segments.

But with that being said, there is probably 10 specific ideas we have kind of going forward into 2020 that we're beginning to execute on as it relates to the entire cost structure. And so, yes, you can think about this as getting a running start on 2020.

Jeff Sprague

And then just the order and revenue performance, certainly impressive, I'll echo that. How are you feeling about backlogs now, Mike? I mean, did you have notable backlog depletion in this quarter? I think the commercial HVAC franchise overall was at something like 21% backlog growth last quarter, if I recall correctly. Just your visibility in Q4 I'm sure is very buttoned up. But how much further around the corner can you look?

Mike Lamach

Yes, pipelines look very strong, coming in backlogs look still very strong. Jeff, I'll go back and look at the 21, you're talking on Q2 versus Q1, I'd have to go back and give you a number, Q2 to Q3. But my guess is we didn't deplete much of the backlog there. It was a strong bookings quarter again for us, so that all feels good.

Even in the industrial compressor business and we've had backlog build on - engineered order compressor is backlog build on oil-free rotary, backlog on services, so there's goodness built up I think in the backlog going forward.

The only place we saw a reduction of backlog would have been in Thermo King. It's fundamentally just a weakening Europe from the last view we had in quarter 2 and then also just some summer cancellations that occurred. But backlog there is still above where it was this year last time, it's just a little bit less than it was last time we spoke, if you heard the last quarter.

Steve Tusa

And just, finally, on TK obviously your comments are around Europe weakness, but kind of all eyes are probably on kind of the ACT numbers into next year. I think you're trying to avoid 2020 outlook here today on the call. But how do you feel about your ability to kind of counteract kind of pressure in that part of the business potentially next year?

Mike Lamach

Yes, I think the context to put it in, Jeff, would, to say that on a pro forma basis Climate Co would have about 5%, through less than 5% of its revenue is associated with North American trailer, which is really what we're talking about here.

And if you took the ACT numbers at face value it would reflect something on the order of an 18% decline between the 49.9 units this year and next year is in the 41 in change range. So if you think about that, less than 5% revenue and 18% drop you end up with something less than one point of revenue headwind to the company.

And I think that only TK has significant levers to pull with a lot of new launches and product innovation coming through in 2020. But I feel good about the HVAC businesses at large and the backlog that we're building there and what I still think is kind of early to mid in the North American institutional cycle as well.

So I feel like without giving specific 2020 guidance, we've sized that we think we've got plenty of levers to pull to have a good year in 2020.

Operator

Your next question comes from Scott Davis with Melius Research. Your line is open.

Scott Davis

It seems like - and maybe I am over reading this that ESG has become a pretty big theme for you guys almost increasingly every quarter. And just what I'm wondering is, how much does this narrow or widen the lens I guess when it comes to M&A for once that deal is done? Meaning, are you more likely to stick to HVAC or think more broadly? Is ESG as a theme overall, kind of afford you at least the mindset to think a little bit more broadly?

Mike Lamach

Well, I think you about - I think you think about it as a funnel, really if you think about the enormity of the HVAC and transport refrigeration markets, and businesses first, that's obviously, what the go forward company is very good at.

And then you look at that in the context of any innovation or idea that we would have that would make sense from a reducing energy intensity, reducing greenhouse gas emissions point of view, it's going to be additive to that. So I think you look at those in combination as opposed to independently.

Scott Davis

I guess that kind of answers it. But I'll move on to the next one. When do you think about...

Mike Lamach

Yes, Scott, I was just - Scott just to be really clear, because I wanted to be clear on this, we've got plenty to do in our co space. And so we're not opening the lens here to think about a third leg of the stool from a sustainability perspective.

We're building the company on its HVAC and refrigeration routes, and to the extent we find things that lower energy intensity and lower greenhouse gas emissions within that, that's sort of a double check for us.

Scott Davis

And just one of the things that sometimes tough to analyze is the mix of non-resis as you think about your order book. I mean, is there a mix change as far as complexity and size of projects, and things like that, that we should think about for 2020 or something in your backlog?

Mike Lamach

In the mix really wouldn't be size of projects. The mixes that come into play here are going to be things like applied systems versus unitary systems, which applied carry a lower initial gross margin. But over the long haul we're pretty agnostic to the margins because service margins really accrue to the applied business.

And then as we're growing the HVAC business faster than the transport business of course the transport margins are higher than the HVAC business. Those are the general issues that we see. But as we look at the business regionally, the EBITDAs from the three businesses regionally are fairly close. And so we're somewhat agnostic to where in the world the growth is, but certainly the actual product or systems or services can change the mix for us.

Operator

Your next question comes from Julian Mitchell with Barclays. Your line is open.

Julian Mitchell

Just wanted to focus on the Climate revenue guidance a little bit. So you took up the guide I think for the year, just over a points organically for Climate. I just wanted to confirm, if that's mostly resi related and you took up your resi market guide for the year. Just when you're thinking over the next 18 months or what have you - any perspective you could provide on the longevity of the resi replacement cycle in the US, understanding that resi is only 15%, 20% or so of the Climate piece.

Mike Lamach

Yes, Julian. We took up Climate really based on just universal strength across the globe and pipeline bookings and backlog in general. So it would have been commercial and residential across the board. The point you made about residential going up, I think it might have been related to last quarter, I think we had a bit of a typo in the deck, we might have said low-single digit to mid-single digit. We didn't mean to do that. It was always mid single-digit. Zack, is that about right?

Zac Nagle

No. We actually put low single-digit in the deck, instead of low to mid single digit, which is what we've always intended.

Mike Lamach

Yes, okay. So we don't really feel different about Razzall year long is playing out the way that we thought it would. And then really to comment on the cycle, we've got over the years pretty good sources of data and analytics that are proprietary to what we use. And because our business is so dependent on replacement, it's well north of 80% replacement for us, we're watching it very carefully. But we really don't see anything here in the near future that would change our view toward a strong 2020 in the residential business for us.

Julian Mitchell

And then just my second quick follow up would be around, just if you could give some more color on the Climate business in Asia. It seems quite choppy. Some of the construction trends there, you've got some tough comps. But you do have the benefits, I guess, of a lot of share gains from that distribution build out you did a couple of years ago. So maybe just give us some context as to how you see growth there in your non-res climate business in Asia and anything on competitive discipline as well.

Mike Lamach

Yes, I think that we're still seeing Asia in general, in China specifically to your question, is being a good market over the long run. You're seeing a change within China around end markets themselves. And so if you think about the three largest markets in Asia, the retail, leisure, and office, all three of those markets are down significantly. Retail is down - am talking about the market, down about 15%, leisure down about 11%, office about 6.5%. Those are big markets that are down.

Interestingly, industrial markets are up, that's good for us and things like education and transportation are up double-digit even though they're smaller markets. But those are the markets that we wanted to focus on from an applied perspectives being longer cycle but core to the economy, core to the 5-year plan in China. So we will continue to, I think, see good markets there and continue to see benefits of the direct strategy that we put in place in China.

Operator

Your next question comes from Nigel Coe with Wolfe Research. Your line is open.

Nigel Coe

So I just want to go back to the productivity buckets and the 80 basis points. How does that land between the two segments? I know you've been restructuring in both segments, so I'm just curious whether it was heavier in one versus the other? And then maybe just touch on the industrial business, what's changed since 2016 where we saw a lot of deleverage in that business. And I know that was partly due to the fact you just acquired Cameron. But what's changed today versus three or four years ago to kind of hold in margins a lot better through a choppy environment?

Mike Lamach

Productivity was about equal between both segments, there is nothing remarkable that we're seeing really there. Inflation would have been higher on the Climate side. So the net would have been a little bit stronger toward industrial net productivity if you think about total productivity over non-material productivity, industrial would have been a little bit stronger. And there there's been really good progress over the years, just to congratulate all our leaders in the industrial space.

Todd has done a very nice job, specifically, in the Compression Technology business around looking at some of this footprint there. And we've essentially gone from a number of larger compressor plants down to a smaller number and if executed that without missing a hitch. And so there's a very strong market work there.

I would tell you within the Club Car business they're doing an outstanding job and they have grown this consumer vehicle into a meaningful part of the business. And every time we sell a consumer vehicle versus a gol fleet vehicle we mix up in terms of the margin.

Pleased with what's happening in our tool and material handling business. And even material handling in particular has been back to the black, after pretty strong declines over the years in oil and gas. And then our fluid management PFS business, really had a record Q3 for them, and so we're proud of what's happening there. Coming out of private equity, it's always a challenge to improve margins. But the team managed to improve margins in Q3.

So just across the board good performance and to us, it's a test of the resilience that we talk about and stress testing our business to make sure that when we do see negative revenue growth that the deleverage can be maintained inside of our gross margins and we get that question a lot from investors. And so it's important point out that when we see this, and we have leverage inside that sort of 30% margin number, it's indicative of the fact that we think we're executing well against the plans.

Nigel Coe

Mike, that's good detail. And then just on the - you pointed out in the slides that big $20 million project you booked in 4Q. What's the outlook for, number one, the funnel for commercial globally? Maybe just touch on that. But specifically these large mega projects, because I'm assuming in NGL net wealth, we will see a lot more of these large projects, maybe rip and replace type projects. So maybe just touch on that please.

Mike Lamach

Yes. It's almost normal now for us to see large projects in the pipeline. It's difficult to predict when they close and what they look like when they are complete. We've got a number in the backlog. I would say not as large as that. But maybe collectively some of the large projects would total that.

So we are seeing see more of that. It is more of a sort of base business for us at this point in time in terms of our ability to execute against that. And we're set up to do that, so we've invested heavily in that business, and we do have a pipeline of larger project sitting in that backlog.

Operator

Your next question comes from John Walsh with Credit Suisse. Your line is open.

John Walsh

I was wondering, if you could talk a little bit about what you saw in service for both the Climate business and the industrial business as well, a little more granularity around those growth rates?

Mike Lamach

Yes, I mean service for both - there has been a strategy for both, I mean, so there is nothing new in terms of our focus on the services business there at all. Service is for us spend something that's grown kind of in the high single-digit range, particularly in the Climate business over the last decade or so. That continues to clip along at about that level consistently as we're going forward.

And then, as you've seen in the Industrial segment from the reports we did here that we continue to see good service growth there - differentiated service growth there to the mix. So maybe a little bit less than what we've seen in climate over time, but again it's been a healthy mid-to-higher single-digit growth in industrial services over time.

And really when we're talking about Industrial Services, it's really in our compressor technology business, and that's generally going to be based off our largest and tropical, and engineered order or larger oil-free compressors as opposed to some of the book in turn smaller compressors, which don't have the same sort of service opportunity.

John Walsh

And then going back to kind of the M&A question. I mean, I think a lot of time we focus on the larger deals, but you did get the smaller deal done here in September? And I was just kind of curious what kind of made this particular company and interesting property for Ingersoll, was it something on the technology side, was it something to do with where their service and sales reps were located? Any color around these smaller kind of single that are out there to do in the industry would be helpful.

Mike Lamach

I appreciate you actually for raising that. We've done about 18 or so of those last few years, a lot them are sort of that size, maybe a little bit smaller. But typically it's going to be a technology that we think is nobel, it's innovative, it's not part of the portfolio today. It may come with a channel, it may not.

But generally speaking, if we can take an innovative product and then move it through the dedicated train commercial channel, it's a home run for us. In other cases, there is also strategy to maintain a second channel through independent reps and that's an important element where we might go to market the train for some of the portfolio, and in this case Arctic chiller for another part of the portfolio, so that multi-channel strategy can work for some of this as well.

This is just a nobel idea around a modular smaller chiller design for modular small applications and it just adds to our portfolio in that regard.

Operator

Your next question comes from Andrew Obin with Bank of America Merrill Lynch. Your line is open.

Andrew Obin

Just going back to Slide 10, if you look at volume leverage, anyway you can decompose it between Climate and Industrial. And specifically what I'm trying to get at, you cited applied impacting volume leverage at Climate and I'm just trying to figure out how bad it was and when does it go away? Thank you.

Sue Carter

So. Andrew, I think as you're looking in at volume in total, I think the volume - that you're talking about the volume leverage is going to come out of the Climate segment, which is what we were talking about with the markets, a little flatter on the industrial side. That isn't going to be the piece of it.

And as we were going through on the different areas, in constructing the slide what we wanted to look at was not only what it was contributing, and then the comments around mix that we've given throughout, the commentary with that being more to the applied side than to the unitary side. But it was more on the Climate side than Industrial.

Mike Lamach

And Andrew on that. I mean, I'm looking I'm seeing volume kind of flowing through pretty much at the 25% level. For Climate it was the mix that kind of pull that back a little bit from there. And if I go to the deleverage the organic side of the deleverage in Industrial, it delevered at about the gross margins of the business, hard a little bit on mix. But again this is where the productivity and imagine, then that productivity equation and price helped that out quite a bit.

Andrew Obin

Yes, that makes sense. And just a follow-up question. I know institutional market is quite important to you, seem to be constructive. If you look at construction put in place data, institutional markets, education, healthcare, it seems to be a mixed at best. So what gives you confidence that this market continues to grow into the year-end and into 2020? Thank you.

Mike Lamach

Well, thank you. What I would say is, when you look at put in place you really only get about half the visible market and the other half of the visible market is the market that you go out and create demand with by putting offers to customers that would reduce their energy intensity or improve operations in their buildings. And so, notwithstanding what you said, what I would tell you that in quarter 3, from a vertical market perspective, the strength we saw was in higher education and in health care.

We saw that and continue to see that going into the fourth quarter, and in 2020 just by virtue of the pipeline that we're chasing. Commercial and industrial, we saw strength there in energy, food, beverage and interestingly even in retail, which gets to be national accounts and some of the brick and mortar out there. So that was again really strong for us as well.

But we're seeing a very good pipeline going forward in these markets and that put in place data really tells only about half the story. Now its indicative of what we're seeing in the marketplace.

Andrew Obin

And do you guys track bond issuance in those markets, do they tell you anything in terms of visibility?

Mike Lamach

Yes. They - well, they do. They get - that's a very long leading indicator toward visibility in the marketplace. Generally speaking, when we know that a school district is going about or applying for bonds, we know generally than what they're trying to do or construct with those bonds.

And so we're doing some preliminary work with schools as they're going out for bonds to get estimates for what things might cost and sort of what it might take from an operational basis to maintain those facilities. That of course is predicated on that bond actually passing and then once that bond passes it can go through a fairly traditional cycle of detailed models and designs, all the way through procurement.

So again it's a very early indicator on a bond. But generally speaking, if we know a school district or a hospital is going for a bond vote, we're going to be working with that customer to understand what the scope of the project might look like.

Operator

Your next question comes from Nicole DeBlase with Deutsche Bank. Your line is open.

Nicole DeBlase

So I just want to start on the climate margins, just to take that a step further. So understanding that you guys did 25% incrementals on volume growth. The 4Q margin assumption seems to embed a bit of a stronger performance versus 3Q. Is that all accountable or attributable to the mix headwind going away or are you anticipating stronger incrementals on volumes as well?

Mike Lamach

Nicole just to be clear, is it - there is another call in the line, right?

Nicole DeBlase

Yes.

Mike Lamach

Yes. Okay, good. I wasn't sure if I was first on the line. So are you quarter 4 Climate leverage, specifically?

Nicole DeBlase

Exactly, yes.

Mike Lamach

Sue, what's your view on that?

Sue Carter

Well - so if you look at the volume leverage in Q4, it is straightly - slightly stronger than it is in Q3. But again the environment is roughly going to be the same as what we were seeing in Q3. So in other words, growth in all of the end markets, a probably same slide towards applied versus unitary. But there really isn't a huge amount of change that comes out of the volume leverage in Q4. But again all of our businesses are going to continue to grow in Q4, residential, the commercial businesses, etc.

Mike Lamach

Nicole, when you look at total leverage for quarter 4, Sue, is absolutely right on the volume piece of it. What I would tell you is that the mix will hurt us a little bit more there. We think about more applied, less transport, we would expect less price than we would have in Q3 sequentially just because we're kind of lapping price there again.

So I would think that we'll manage the full year for the enterprise with the same 25% we talked about. But I would expect that quarter 4 will look a lot like quarter 3 for Climate, probably not any better.

Nicole DeBlase

And then you brought up price cost, it seems to me that because you're lapping tougher pricing comps and 4Q price cost impact to margins probably comes down a little bit. But thoughts on that, and then any early thoughts into 2020 just specifically on the price cost front?

Susan Carter

So if you think about Q4, I think the back half of 2019 is similar. So I think you'll see about the same thing in Q4 that you saw in Q3. And as I think about 2020 - so I am going to give you an answer and it's not going to be what you want, which is what our guide is. But when I think about 2020 and I think about tier one materials on steel, copper, aluminum, should all be on the surface deflationary.

So in a good spot, we see the spot prices coming down, we're seeing it in results. And that should be a really nice tailwind, if you will, going into 2020. However, is that - as we look at this, we want to watch this play out over the upcoming months, because we just do not know what the tariffs and all of those pieces are going to mean to 2020.

So in other words you could have deflation on those base materials and you could be offset by tariffs. You could have a change in the tariffs and that's just something that we're not comfortable with trying to give that outlook on. So I can tell you what I see on spot prices and then what we're doing on early buys of material going into 2020. But we'll just watch the environment and then as we get closer to 2020 give you a guide on what we think it looks like at that point in time.

Mike Lamach

Nicole I'd say that there has been so much as you know volatility around news and announcements coming out around tariffs that unfortunately, we've gotten pretty good at being able to react to it. It takes us about two days to get from an announcement or a change to having that flow through and understand from a growth perspective, what the impact is and it takes us maybe a week from that point in time to understand what we think we can do from a net perspective around mitigating some of that.

And therefore, then we know at that point in time, probably a week or so later, what we need to do from a pricing perspective and so volatile. That I think, we're comfortable with our ability to react and change and understand and push sort of pricing through and mitigate what we can, that at this point in time, we're not trying to guess where things go in 2020 there.

Operator

Your next question comes from Josh Pokrzywinski with Morgan Stanley. Your line is open.

Josh Pokrzywinski

Mike, just to follow-up on, I think a couple of questions trying to get at maybe kind of the shift and climate over time toward more sustainability and energy efficiency. It seems like a lot of your competitor’s talk more about selling boxes and you guys are talking more about selling solutions. Can you give us a sense for how that mix has evolved in terms of just kind of straight away product sold through traditional channels versus something that, is this more kind of comprehensive sustainability path?

Mike Lamach

Yes, I think two things have happened I mean, one is that obviously the world is looking at regulations differently around greenhouse gas emissions, understanding the impact of refrigeration systems on the environment that's one. Two, as these systems become greener, if you don't do anything to the fundamental underlying system, the refrigerants tend to be less energy efficient. So you're on your end up using more power to generate the same level of cooling and heating in the system.

And so from a system level, it's really making sure that you can reduce the energy intensity while using next-generation refrigerants. And so there's a lot of innovation that goes into that. It also feeds right into how we think about the need to have a direct a very high-quality sales force at there. It's typically engineers or professional engineers selling to professional engineers and our customers in the commercial space in that model exists for us all over the world, because these are complex trade-offs. And then as you think about 30 year lives on many of these systems.

Any innovation you have an advantage you have and what the cost of maintaining those systems will be, it can be a very meaningful sort of a kicker to total cost of ownership. And so, it's just the way we go to market, it's our model and when we think about creating demand. It was the earlier question about put in place. And I said about half of it is put in place and half of it is going out and creating demand.

The half that we go out and create demand with are looking for those kinds of customers that understand this technically and are wanting to do something about it and may have systems of age, a variety where there is a particular opportunity to go have a high return on invested capital. And so, it's just a more sophisticated sale and way to market and that's what we train people to do. I mean we train them technically. And then we train them financially around how to go make the case.

Josh Pokrzywinski

So it's really all the mix has shifted toward this. It's kind of getting away from how you need a box for the top of your strip mall and we'll sell you one.

Mike Lamach

Well, it's really - time it's - you try to move away from responding to quotes to creating specifications, creating opportunities and creating your own demand and that is the control element of what we do even in a downturn. Right, as opposed to sitting back waiting for something to be built and asking you. So we asking you for a price, there is plenty to do in the world today, to go out and create an opportunity for return on investment for somebody.

I think two as in a downturn and I said this very often, we fully expect both our service business and our performance contracting business to increase, because you have to maintain or extend asset life and a few - we no longer extend the asset life. We've got a way of paying for these assets through the energy savings that we're willing to guarantee as part of the asset swap.

Operator

There are no further questions queued up at this time. I'll turn the call back over to Zac Nagle for closing remarks.

Zac Nagle

Thank you, operator, I'd like to thank everyone for joining today's call. I apologize to anyone who is not able to answer - or get a question asked in the queue. However, Shane and I will be available all day today and obviously in the coming days and weeks to answer any questions that you may have. And we encourage you to call and we look forward to seeing on the road soon. Thank you.

Operator

This concludes today's conference call. You may now disconnect.