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Emerson Electric Co. (EMR) CEO David Farr on Q4 2019 Results - Earnings Call Transcript

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FQ4: 11-05-19 Earnings Summary

Press Release *10-K* *Slides*

EPS of $1.07 misses by $-0.00 | Revenue of $4.97B (1.70% Y/Y) misses by $-52.06M

Earning Call Audio

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Emerson Electric Co. (NYSE:EMR) Q4 2019 Earnings Conference Call November 5, 2019 2:30 PM ET

Company Participants

Tim Reeves - Director, Investor Relations

David Farr - Chairman and CEO

Frank Dellaquila - SEVP & CFO

Lal Karsanbhai - Executive President, Automation Solutions

Bob Sharp - Executive President, Commercial & Residential Solutions

Pete Lilly - Director of Investor Relations

Conference Call Participants

Julian Mitchell - Barclays

Steve Tusa - JPMorgan

Nicole DeBlase - Deutsche Bank

John Walsh - Credit Suisse

Andrew Obin - Bank of America

Joe Ritchie - Goldman Sachs

Andrew Kaplowitz - Citi

Robert McCarthy - Stephens

Jeff Sprague - Vertical Research Partners

Josh Pokrzywinski - Morgan Stanley

Operator

Good day, ladies and gentlemen, thank you for standing by. Welcome to Emerson's Investor Conference Call and Webcast. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] This conference call is being recorded today, November 5, 2019.

Emerson's commentary and responses to your questions may contain forward-looking statements including the Company's outlook for the remainder of the year. Information on factors that could cause actual results to vary materially from those discussed today is available at Emerson's most recent Annual Report on Form 10-K as filed with the SEC.

I would now like to turn the conference over to Mr. Tim Reeves, Director of Investor Relations at Emerson. Mr. Reeves the floor is yours, sir.

Tim Reeves

Okay. Thank you, Mike. I'm joined today by David Farr, Chairman and Chief Executive Officer; Frank Dellaquila, Senior Executive Vice President and Chief Financial Officer, Lal Karsanbhai, Executive President Automation Solutions; Bob Sharp, Executive President, Commercial and Residential Solutions and introducing Pete Lilly, the incoming and upgraded Director of Investor Relations, who will surely not mispronounce Frank's name.

Welcome to Emerson's Fourth Quarter 2019 Earnings Conference Call. Please follow along in the Slide presentation, which is available on our website. I'll start on Slide 3 with the full-year performance report card. 2019 required our organization to be nimble and responsive to a lower growth environment than we had expected a year ago and we did respond.

On our second quarter earnings conference call, we began talking about additional restructuring actions and we did so again on our Q3 call in August. In total, we executed $35 million of additional actions in the second half and on October 1st, we announced our Board's review of further actions appropriate for the lower growth environment we see over the next couple of years.

Underlying sales finished the year up 3% versus our initial guide of 4% to 7%. We saw slower than expected growth across both platforms, Automation Solutions grew 5%, which was mostly driven by efforts targeting our broad installed base. We saw large capital projects start to push out in Q2 and that trend continued through the second half. Commercial and Residential Solutions saw a sharp decline in Asia in the first quarter and was a headwind to growth all year.

Cooler weather hampered residential growth in North America and professional tools and cold chain markets began to slow through the second half as non-residential investment slowed. Despite slower growth, we delivered just above our EPS guidance helped by lower tax rate and lower corporate costs. Importantly, we had a strong cash flow for full year, delivering free cash flow at $2.4 billion, which was up 6% and reflected 105% free cash flow conversion. This drove dividends as a percent of free cash flow down to 50% a critical milestone.

In 2019, we completed our 63rd year consecutive dividend increases and returned $2.5 billion to investors including $1.25 billion of share repurchases, which was above our initial target of $1 billion. Today, we announced a $0.04 dividend increase in 2020.

Please turn to Slide 4. Fourth quarter results were above the high end of EPS guidance discussed on the third quarter conference call, helped by a $0.09 discrete tax benefit. Automation solutions was in line with guidance with 5% underlying growth in Q4 and full year EBIT margin of 16% spot on with guidance. Trends in the business continued into Q4 with slowing global discrete markets and soft North American upstream activity.

Demand in global process in hybrid markets remained stable. Commercial and residential solutions end markets were slower than expected and the business deleveraged on lower growth. Q4 underlying sales were down 2% compared to our expectation that the business will be up slightly in the quarter. Our fourth quarter free cash flow generation was up significantly versus prior year and we completed the $250 million of additional share buybacks announced on our Q3 call.

Turning to Slide 5. Fourth quarter gross margin was up 70 basis points to 42.8% and full-year margins were 42.5% demonstrating strong price leverage and cost disciplines. SG&A cost as a percent of sales fell 180 basis points as our businesses effectively control costs. Operational SG&A spend was lower compared to the prior year and also lowered sequentially compared to the third quarter. Lower corporate expenses also contributed to this improvement, lower stock compensation and the favorable impact of the prior year one-time 401(k) contributions.

Reported EBIT margin was up 140 basis points. In 2020, we will report adjusted margins, which exclude the impact of restructuring charges consistent with our new adjusted EPS framework, which we'll discuss in detail shortly. 2019 adjusted EBITDA margin was up 210 basis points to 22.8%.The quarter benefited from discrete tax items similar to the prior year. Fourth quarter EPS was up 20% excluding these discrete tax items from both years.

Turning now to Slide 6. From a geographic perspective, we saw mixed results in Q4. In total, mature markets were down 1% underlying in the quarter and up 2% for the year. U.S. industrial activity softened a bit in Q4, somewhat offset by stronger Western Europe.

Emerging markets were up 8% underlying in Q4 and up 4% for the year. Strong fourth quarter emerging market investment activity was led by China, up 9%. Latin America up double digits and Middle East and Africa up 8%.

Turning now to Slide 7. Total segment margin was up 10 basis points, including recent acquisitions. Total adjusted segment margin was up 50 basis points to 20.2%. This improvement reflects greater than 40% year-over-year and sequential leverage. We've updated our reporting of corporate and other costs. Previously, we showed two numbers, the differences in accounting methods line, which included a management charge to the operating segments and certain pension and post-retirement costs and the corporate and other line that included corporate operations, total company stock comp expense, acquisition and related -- acquisition related costs and other items.

Going forward, we will present three-line to more clearly show the pension and post-retirement cost the corporate, the stock compensation expense, and the corporate and other line, which includes the cost of corporate net of the charge to the businesses, acquisition related costs and other items. We believe this presentation provides greater clarity and is more in line with how our peers report. Q4 cash flow was strong. Free cash flow of $1 billion was over 20% of sales and free cash flow conversion in the quarter was 140%.

Turning to Slide 8. Automation solutions underlying sales were up 5% in the quarter and up 5% for the full year. September trailing three-month underlying orders were up 4% excluding two large nonrecurring power projects in the prior year. Strong demand continue to cross MRO spending and brownfield projects supported by primary demand, growth programs focused on our installed base. We continue to see long cycle bookings, with the September backlog for final control and systems businesses up 6%; however, our large project funnel continue to stall, as customers' capital spending plans push out due to trade tensions and geopolitical uncertainty.

North America underlying sales were down slightly as discrete and upstream markets continued to soften. Strong growth continued in Latin America. Demand in Europe was stable in the quarter and underlying sales growth accelerated on strong backlog conversion. Asia, underlying growth was broad-based led by China, which was up 18%. Strong growth in Middle East and Africa was driven by long cycle investment activity.

Automation Solutions segment margin was up 70 basis points including significant restructuring investments executed in the quarter. Adjusted segment margins was up 140 basis points to 19.5%. For the full year, excluding the dilutive impact of acquisitions, automation solutions delivered over 30% leverage on an adjusted basis.

Turning to Slide 9. Commercial and Residential Solutions underlying sales were down 2% in the quarter and down 1% for the year. September trailing three-month underlying orders were down 2%. North America underlying sales were down slightly with cooler weather affecting key HVAC markets. Additionally, slower industrial markets weighed on professional tools and cold chain demand. Latin America demand remained solid.

Underlying sales in Europe were down slightly reflecting weaker trends in cold chain market somewhat offset by steady growth and heating and commercial air conditioning markets. Asia, Middle East, and Africa was down 7% underlying with China down 9%, primarily reflecting modest declines in commercial air conditioning in the cold chain markets partially offset by steady growth in professional tools. Commercial and Residential Solutions margin decreased 120 basis points and adjusted margin decreased 110 basis points. Lower profitability primarily reflected deleverage on lower volume and unfavorable mix, partially offset by favorable price cost.

Let's turn to Slide 10, which outlines our 2020 guidance framework. With the slowing macroeconomic backdrop and continuing geopolitical tension, we are planning for a lower no growth environment in 2020. For the full year, we expect underlying sales growth of down 2% to up 2% with Automation Solutions down 1% to up 3% and Commercial and Residential Solutions down 3% to up 1%. We expect reported sales to be slightly down with a point of FX headwind on the stronger dollar.

As Emerson has consistently done during economic slowdowns throughout our history, we have just a shifted our management and investment focus from a growth mindset to cost. We started this process in Q2 and in total, we increased restructuring investments to $35 million in the second half of 2019. As announced on October 1st, the Board initiated a review of operations, capital allocation, and portfolio initiatives, the 2020 outlook framework presented here does not include any potential implications of the Board's review.

At our February Investor Conference, we expect to present a detail the outcome of the Board's review and an updated 2020 framework -- outlook framework. Although we anticipate significant restructuring investments in 2020 as a result of the Board's review, our adjusted guidance framework excludes restructuring charges entirely. That is we have zero restructuring charges built into the outlook.

Adjusted EPS guidance also excludes significant discrete tax items. We expect adjusted EPS for 2020 in the range of $3.48 to $3.72 against a 2019 adjusted EPS of $3.69. The guidance focuses on operational improvement and margin expansion to drive earnings growth, which is more than offset by $0.29 of headwinds related to tax, unfavorable FX, higher stock compensation due to higher stock price and higher pension expense due to lower discount rates.

In 2020, we anticipate another strong cash flow year, as we continue to drive operations execution and incremental cash flow from recent acquisitions. 2020 operating cash flow is expected to be $3.1 billion and free cash flow conversion north of 100%.

Please turn to Slide 11, which bridges our 2020 adjusted EPS guidance.The starting point for the bridge is 2019 GAAP EPS of $3.71 and walking across to adjusted 2019 adjusted EPS of $3.69 by excluding $0.14 of favorable discrete tax items and adding back $0.12 of restructuring charges. Now walking from $3.69, we discussed first the $0.29 of headwinds next year. First, tax, the 2019 adjusted tax rate is 21.6% excluding the discrete tax items last year. This is 1.4 points better than expected 2020 rate of 23% resulting in a $0.06 EPS headwind.

Second, FX, the stronger dollar results in an FX translation headwind next year assuming October 31 FX rates hold for the remainder of 2020, we anticipate $200 million unfavorable impact in net sales, resulting in a $0.04 EPS headwind. And finally, stock compensation and pension. Stock comp is up due to higher stock price and pension cost increase this year due to lower discount rates. Partially offsetting these headwinds, we expect to drive $0.08 of operational improvement on flat to down sales, which reflects 30 basis points to 50 basis points of improvement in adjusted total segment margin. We also expect $0.12 of EPS from our improved debt cost structure and strong balance sheet with $1.5 billion of share repurchases.

Please turn to Slide 12, which bridges our first quarter 2020 adjusted EPS guidance. For Q1 last year, we add back a penny for restructuring charges to $0.75. There were no discrete tax items in the quarter last year. The 2020 bridge for Q1, looks a lot like the full year bridge with half of the headwinds we discussed in the full year impact the first quarter. This is because Q1 last year benefited from lower stock compensation due to the decline in our stock price in late December, as oil prices fell.

In total, we faced $0.13 of headwinds, which were partially offset by $0.02 contribution from operations and $0.03 from shares and interest. These items provide $0.05 of EPS contribution, which is proportional to the $0.20 we expect in the full year.

And now, please turn to Slide 13 and I will hand the call over to Mr. David Farr.

David Farr

Thank you very much, Tim and thank you very much for your service as Investor Relations and going out sort with a bang. It's an interesting time we've been having here. But I want to thank all the employees around the world for their support through Fiscal 2019. They did accomplish a lot in a very challenging marketplace.

And I want to welcome everybody on the call today, as we talk about what we're seeing in the marketplace and what we see going here going forward. But it's been a very dynamic time period as we all know. It's a challenging time period, but the management team across this Company, both here in St. Louis and around the world is very, very focused on delivering increased operational margins and a 0% underlying growth period.

If the growth is better, better for us; if it's not, we're ready for it and that's what we're doing. I also want to thank all the sell-side analysts and the shareholders that have met with Tim and I over the last 60 days and talked to us as we look sought your inputs, which we conveyed back to the Board, as we've gone through this process to make sure the Board understood, where our shareholders stood today and what they expected of us.

So if I look at where we're going right now, and you see that the order pattern in Chart 13, preliminary numbers for October, if I look at automation solutions, they drifted down a little bit but not much, running around I think around 3% underlying growth rate. Bob's business is sort of flat lining here around this negative 1 to 0% growth rate for the last couple of months. And overall, we are as a corporation looking at 1% underlying growth rate right now. As we know, we believe we're facing a very challenging time in 2020 and we are getting ready for that, and I'll have more comments on that as we go forward here.

If you look through the Chart 14, the history of Emerson from the years that we've gone through different cycles through period that I've been leading the Company as a CEO from 2000 to 2019. We have continue to the change the composition of the Company, we've continued to invest in the Company, we've divested close to 55% of the Company's assets since I've become CEO.

We repositioned and invested in new companies in our automation business invested in new companies in our commercial, residential business and we've driven our gross profit to very good levels. Our target is to get the number back into that 44 and plus percent range over the next couple of years, but we -- from an industrial operation standpoint, we know what we're doing here. We know how to invest in technology to drive higher gross profit and to drive what I'd call renewable type of business model as I look at our aftermarket business going forward.

We've had very good through underlying growth rates throughout the economic cycle. Yes, there are cycles. And yes, we're facing a cycle right now and I believe this team is focused on how we're going to improve the profitability and drive as much growth as we can for our shareholders going forward here in the next couple of years.

If you look at Chart 15 from the EBITDA margin standpoint over the time period, Emerson 21%, our weighted average peer is around 16%. Our Commercial and Residential Solutions business, is a very profitable business, a business run that runs through cycles a little bit different, a little less cyclical, runs around 25% EBITDA versus our peer group around 15%. Automation Solutions business also a very, very good business, it's been built up over a long, long time. I ran it many, many years ago, but I'd say the current leadership team is far better than I ever was back when I was running it in the late '90s but running an EBITDA around 20% versus our 15%, but we believe we have opportunities here to drive this EBITDA margins back up to its peak levels and to enhance our profitability, as we go forward in the next couple of years, and we'll be talking about that a little bit more.

If you look at our digital transformation capabilities today, we now have a very large installed base, close to $120 billion in our automation world. We have a capability with the -- our digital capability today both from a hardware standpoint and a system standpoint and we're driving unique business model around that while creating a new business within that, the focus specifically on is higher tech transformation opportunities and we have a very good start in this business today. You're going to hear more about that, as we now start talking about what we're doing, what we have to offer here, but it's really a truly unique differentiation that we have and really from the standpoint of our $120 billion installed base, it's quite unique to come off of.

And I'm -- we're very, very excited about it and we'll continue to invest in that even through a tough time, we will continue to invest in that. I also want to thank Lal and Ram and his whole team in the first couple of years of the Valves and Controls work, it's really created unique shareholder value for us, from an EBITDA standpoint, the pro forma of 2017. If you look at 2019, we're now over $600 million of EBITDA and EBITDA margins are now up 16%. We fundamentally have room to go.

We made a commitment to our shareholders that we would get to 20%, we will get to 20%. We are doing the necessary action to get to that level. It is a step by step basis and we're under way right now. We've decreased the number of facilities, you'll see more of that in 2020. We've driven out working capital on a combined basis when we took over V&C that number is close to 50% and on a combined basis, the Final Control was 35 total and we're now down to 26. We're doing a lot of different things here to drive value both from the customer perspective, but equally just important for our shareholder perspective and a lot more to go here for Ram and his team and Lal, as they go forward with this integration process and we will continue to accelerate that in 2020 and '21.

We've also continued to drive a lot of cash and back to our shareholders. If you look at our Emerson capital allocation over the last 10 years, we paid back to our shareholders in $10 billion a share repurchase, $12 billion of dividends, acquisitions we've done $10 billion worth, capital spending we've done about $6 billion worth. So we've continued to invest in the Company, continued to investment in technology and we continue to give back to our shareholders. In the last 10 years, that number of 57% of our cash flow goes back to our shareholders. This year we're over 60% as we drove back our dividend and as we grow back our share repurchase, we clearly had money to give back to the shareholders, we did not have as many as acquisitions and our intention is to give the money back if we can't use it internally.

On a return basis, as a company over the last 10 years, our return on total capital has been 18%. It is a number that goes up and down, as we make acquisitions, the number will drift down, as we integrate those numbers will drift up and over the time if you look through it. It does go up and down, but we drive at very high levels of return on total capital, a very important metric for us, both from cash standpoint, from a sales standpoint and margin standpoint, but returns on our investments from the shareholders' perspective is something it's high in our mind at all times.

If you look at the Chart 19, the only thing I want to point out is we go through the different cycles. You look at Emerson and you look at our G7 or G7 with China, the numbers cycle around. We are definitely in a downward drift right now. The concern I have, as I look at 2020, as I look at the GFI numbers right now, they're under 1%. That tells me we are facing a very challenging time period. I'm waiting for the catalyst to cause it to turn. There are a lot of people who believe that we'll see a second half recovery. We are not planning on that. We are planning on getting the cost out, getting our margins moving upward in a no-growth environment.

If we did grow, then we'll leverage nicely. But right now, what I see and I've been in this game, a long time, as you all know, I see a very challenging environment for at least 12 months, it could be 18 months and we'll see what that catalysts is that drive that. I firmly believe there will be a bounce back up. This cycle has been artificially depressed of the geopolitical issues, the trade issues, and I'm looking at what does it take to bounce it, from my standpoint, we're betting on a slow global growth for the next year, a challenging growth for us and we're adjusting accordingly.

We are going through the repositioning review with the Board right now. We have a lot of work to do. The effort is under way. It has been under way for several months. We will come back out to the shareholders later, after the first quarter and getting into that in February Investors call. But I'll tell you what I'm thinking right now. We are trying to aggressively advance our restructuring efforts. You're going to see in the first quarter restructuring number around $70 million and basically what we see at this point in time between Lal's business, between corporate and Bob. We're looking at around $70 million of restructuring on top of what we just did in the fourth quarter incrementally was $35 million higher.

As I look at the total plan from the late 2019 to '20 to '21, early '22, I would say right now, you should be factoring somewhere between $200 and $300 of restructuring as we go back to drive our EBITDA margins, or EBIT margins to record levels to high levels, and that focus is under way. The work will be done and reviewed with the Board in the coming months and then we'll share that with the outside investors, but we're well under way and we're going to take a significant hit in this first quarter, as we really action around things that should be done and to get going on this and that will come through and we report our final GAAP numbers.

It's not in the numbers that we presented to you today, but it will be around $70 million and I would expect that number obviously never hit exactly, it's going be plus or minus, but that's what we're talking about in the first quarter, up from what we just spent in the fourth quarter of our Fiscal year. So if you look at what's going on right now, the Board has is looking at operational review, looking at total cost structure across the Company, both on Bob's business, our corporate organization and Lal's business, how can we optimize the cost structure to get back to driving record levels of EBITDA margins, EBIT margins. We've hired outside global consulting firm to work with us to look at the pinch points to make sure we're not missing something.

We consider ourselves very good operating people, but having a different perspective is something is very valuable. And that's why we brought in somebody to look at this and that's under way. Again, we will review that with the Board, the Board wants engagement in this and we're going to make sure that we take a hard look at that with the Board in early February. We're also looking at the capital structure, we're looking at our capital allocation, where we see spending money, the next couple of years, how much we see in acquisitions, how much we see going back at dividends, how much we see going back in share repurchase, how much we see going back into capital spending.

Again, we're looking at where we're going to spend the money, as we go forward here. I know that we're going to put more money into capital as we rebase some of our cost structure. I also know that we will continue to drive operating cash flow and free cash flow, which will allow us to increase our dividend, as we drive down toward 45% of dividend payout versus free cash flow. We're at 50% this year and we want to get back down to 45% level. And finally, we'll take a look at all of the portfolio of Emerson, what assets makes sense, what asset don't make sense, what we can do if anything, what we can do with some of these assets, some of the businesses. This is something we do all the time, but we really put a little bit more effort into it.

We like to look at this, especially when we go into a downturn allows us a remix and it also allows us to have a chance to say, where do we want to invest from an acquisition standpoint. So everything's on the table. We had a two-day Board meeting this week on Monday and Tuesday, and we're looking forward to sharing a lot of the insights with the shareholders in our February Investor Conference, which is I think February 13th in the New York City at the famous Stock Exchange, which everyone loves to go to, but it's a good price point from a standpoint of costs. And so that's why I'm looking at it from that perspective.

But I want to know -- let you know that the Board and the Senior Management are very focused on how we can drive improved profitability, improve profit margins and also drive growth. We're not walking away from growth. But we know we are facing a challenging market. I know the entire organization around the world is focused on that. We're also making the right investments for the next generation technology, the next-generation area that really will drive growth and we're getting ready for what I would say a bounce back in the marketplace when it does happen. In the meantime, we're very, very much focused on driving that value for our shareholders through that margin improvement, the cash flow, and we're very much focused on driving that cash and paying back more money to our shareholders in 2020.

Through the higher dividend increase of $0.04 this year, assuming we continue that and also share repurchase of $1.5 billion this year. So our forecast right now says we're paying back more money to our shareholders in 2020 and we are also looking to drive higher operating cash flow.

With that, I'm going to open the mic and allow first questions and we'll go from there. Thank you very much.

Question-and-Answer Session

Operator

Thank you, sir. We will now begin the question-and-answer session. [Operator Instructions] First question we have will come from Julian Mitchell of Barclays. Please go ahead.

Julian Mitchell

Hi, good afternoon. I wanted to say thanks to Tim for all the help over the past several years. In terms of maybe the first question, David. So there's been a lot of sort of back and forth between D.E Shaw and Emerson and we saw that press release this morning, how would you characterize where you stand vis-a-vis D.E. Shaw right now and also when you're thinking about the Board changes we saw the Mark playing announcement, should we expect further Board changes in the quarters ahead?

David Farr

Okay. Thank you very much. So what I'd like to do here is sort of deal with this issue right upfront here and then not have that question come out to me for the rest of the day. I want to focus on Emerson and what we're trying to do here. But first of all, we get input as you all know from every shareholder and it's been part of Emerson DNA for a long, long time.

It's how we operate and the Board review announced in October was the combination of discussion with the Board over the last six months and the consistent with how Emerson addresses challenging macroeconomic slowdown.

The Board's decision was shaped by input from all our shareholders. That's why I went out and I asked so many of our shareholders. I talked to nearly 40% of our shareholders over the last two months. The Board members have joined me on several of these phone calls and meetings. It's important for them to hear it. The Board understands our strong position as a company and the Board supports that we have heard from our shareholders and the Board will continue to make the right decisions for the long-term for all of our shareholders. We appreciate your inputs,

as I said earlier from everybody that I've talked to, over the last 60 days. It is important that we -- the shareholders to know that we are in control of our own destiny here. We are in control of what needs to be done with our strategy. Now, as I look at what we announced this morning and with Mark -- what we have been looking at for the last couple of years is we have two Directors, who will be retiring in early 2021. The Board Corporate Governance Committee have been looking at candidates for quite some time. We've had two candidates that we've been working on. We had an input from a shareholder.

The Board took a look at it. He was a very interesting person from the standpoint, every Board member met this individual, went through a very rigorous process and we made the decision as a Board to move into the front line versus the other two candidates that we have at this point in time. Mark has unique skill sets. He has a unique experience in the industry. He took a company through a major repositioning effort or restructuring effort. He has enormous Board experience being on the Texas Instrument Board as a Lead Director. He has an interesting background also from a CFO standpoint. He is on the Board Legrand Platt, and he is on the Board of other companies, which really do bring value to us.

So, the Board made the decision that Mark fits exactly what we're looking for any moved to the front of queue and we brought him on. And from my perspective, at this point in time I think he's been a fantastic addition. Mark -- I've known Mark for several years and I'm looking forward to his inputs relative what's going on in the industry. And I think that obviously we listen to shareholders and we are totally in control of our destiny at this point in time. Our objective right now is to execute, execute around what I've been talking the Board about and what I've been talking to my shareholders about. We are in total control of our own destiny and I want to say, Mark, was a very good addition to our Board.

Don't be surprised if I don't add another Director in 2020, late 2020, because I do have this Director that will be retiring in late or early '21 and I need to make sure that I find a replacement for her, at the same time. I'm looking for a diverse candidate there and the Board is looking at that at the same time, so Julian, I appreciate that and I want you -- if you have another question, you might want to ask, go ahead.

Julian Mitchell

Sure. Maybe looking at some of the other investor suggestions that have been floating around, I think on the portfolio you've made it clear that sort of many things are on the table, maybe on the restructuring aspect, how do you and the board think about balancing that need for cost efficiency against also the need to keep investing given a lot of changes that are going on in the automation world right now.

David Farr

It's a very important point for the Board at this point in time, the Board is very focused on trying to make sure that we're not jeopardizing the future of this company. We've done several large acquisitions in the last 2 or 3 years. We're taking -- we're taking a very strong focus on how we can integrate those businesses, how do we get our cost structure, improved there.

We're taking a hard look at the touch points between the corporate and the businesses and as I committed to the Board, both Bob and Lal had to commit to the Board yesterday because they asked the question, the same question is asked us how you making sure you're not jeopardizing the future of the Company, just because you're trying to get to the short-term type of goals.

That's not something Emerson does. We over the time has been a technology leader, we've been an industry leaders, the industry and we have not -- have no intention to damage that going forward and these guys talk later on, you can ask the same question, but these guys are very much focused on the key strategic areas we have opportunities in the size of the Company to take our cost down and do things better.

We have some excess facilities through acquisitions. We have a unique opportunity to do some best cost job moves by building some new facility. So, Julian, it's -- it's a very important issue for the Board, because they do not want to make sure that Dave Farr in his last two years, does things short-term orient and then hands it over to the next generation, say, oh, "shit" and so I guarantee. That's on the forefront of the Board and they will be challenging me, they'll be challenging Bob and Lal to make sure that they do that.

Bob, you guys want to say anything or Lal, you want to say anything along those lines.

Lal Karsanbhai

Yes, David, thank you. This is Lal Karsanbhai. We've been looking at this weaker environment for some time now in operating in a world that's changed since we last spoke in February. And we've been accelerating restructuring across the platform, as we executed to Q3 and Q4 and as we look at the opportunities today, we are focused around structure across the enterprise, we structure we're prioritizing enhancements in speed and execution.

And the key priority for my management team is around protecting our customer touch points and protecting our technology and that's how we're working around the opportunity.

David Farr

Bob, anything you want to add there?

Bob Sharp

Yes, I'd say -- Investor Call again in February, where we talk more. I'll show you several examples of programs will drive and we continue to drive both to expand the serve market we have and get growth and it is a challenging trade off when you get a situation like this , but we are continuing to fund those and from our restructuring and cost standpoint, we're very heavily focused on the gross profit side of things in the plants and product cost and such, so we're going to use that to also help fund some of the key sales programs.

David Farr

Yes. I think the important point Julian, anything else before I pass it on the next person.

Julian Mitchell

Maybe just one last one, you talked about slowing growth in North America, I think on Slide 6, just wondering if you could give a bit more update on within automation solution specifically is all the weakness in North America still focused on upstream and discrete or do you see it spreading.

David Farr

I'll let Lal answer that question, since he is an expert in this and I'm just a CEO.

Lal Karsanbhai

I got that. Thanks, David. Julian, the weakness that we experienced in the second quarter leading through the year on discrete continues and has continued through to the fourth quarter and then to what we currently see in the environment. Likewise, we continue to see stresses around the upstream and midstream, oil and gas value chain in North America with very little spending and more acceleration of spending in the, in those markets. I have not yet seen a broader slowdown in process, particularly resi relates to MRO spend. Having said that, the North America capital environment slowed down, it's been delayed, it's been impacted by the geopolitical and general economic situation.

Julian Mitchell

Thank you very much, Lal.

David Farr

Well, we should move forward who is up next.

Lal Karsanbhai

Thanks. Julian. Thank you.

Julian Mitchell

Thank you.

Operator

And the next question we have will come from Steve Tusa of JPMorgan.

David Farr

Good afternoon, Mr. Tusa.

Steve Tusa

Hey, guys. Good afternoon. Just on the -- on the organic guidance, I mean you're starting the year up model was for the first quarter on organic your -- you know negative two to positive, I would think in climate at some point in the next, I don't know like 10 quarters you guys will have somewhat of an easy comp, at some stage of the game. What is really bugging you within Automation Solutions , especially given you have, I mean it is process, it's kind of a backlog related business and you should, the MRO business shouldn't be that the lack of visibility there shouldn't be that. What exactly is the driver that kind of gets you to below the flat line for the year on organic.

David Farr

I think -- see, it's a fair question, given where we are in the -- from the backlog standpoint, in the order plan standpoint. I'll give you my perspective and let Lal and Bob give you two seconds on this too. From my perspective, what's scaring me is I look at the last couple of months starting -- I started talking about concern about 2019, late 2019, early 2000, back

back in April, but in the last two or three months, I've seen the global GFI numbers really roll off and when I see a number that goes now GFI forecast for 2020 drop now below 1%, it scares me from the standpoint, okay guys.

At the current pace, we see maybe says it doesn't do that, maybe should be better than that as you say, but I'm more concerned about the fact that the trend line between the geopolitical, the tariffs, the trade all these different discussions right now are driving this much weaker gross fixed investment number. When I see a number go below one, historically, we move really quickly toward a zero or a negative number on underlying sales, so what -- so from my perspective, what I'm doing right now is say guys, we are driving to zero or negative number underlying growth.

I understand there's investment opportunities out there, but we've got to figure out how to get the cost structure set at that zero standpoint Steve, because I'm concerned, that's something is going to happen here from an election standpoint or Europe or something happens in the Middle East and the GFI forecast numbers are really going to happen. If that happens, we are going to be looking at a very low growth.

So I would say I'm being driven by that caution and I think that until we see that catalysts that drives that back up, you're right It should be from a catalytic standpoint, at some point a balance. But I'm not willing to say we're going to see that balance yet until I start sensing, the underlying economic numbers get better or stabilize. I don't see that yet. So that's where it's coming from.

Steve Tusa

At the low end of that range, what does that imply for your short cycle discrete business, which I would assume is going to be the the leader of that kind of negative view in the context of your other businesses, what are kind of low end of declines in discrete?

David Farr

Lal, go ahead.

Lal Karsanbhai

Yes. On the broader -- on the broader process of the issue.

David Farr

Yes and don't forget the discrete question.

Lal Karsanbhai

I'll come back to that. Steve, the capital discipline that we see out there the spending disciplines, the way our customers are looking at where they put that dollar today is where we've got to really assess how that looks goes forward. We've seen that slowdown in North America in oil and gas. We've seen in the discrete globally.

I have not seen and likely will not see tied to this economic cycle of turning the discrete markets as you -- closely tied to GDP and GFI trends and we are yet to see a recovery across the broad, discrete markets, whether that's automotive, semiconductor, packaging, textiles, et cetera. And I don't foresee that coming back. So as I think about discrete in that mix, it's somewhere in the mid-single digit negative at the low end of the forecast.

Steve Tusa

Okay. That's great. I'll leave it there. Thanks guys.

David Farr

Okay. Anything you want anything from Bob. Anything want to ask Bob on?

Steve Tusa

I'll just pick few questions. I'll leave it there.

David Farr

Bob will make a statement here then. Since you won't ask him a question, Bob, once you can make a comment because Tusa doesn't like you enough.

Bob Sharp

Well, I would just say I think you know that of my order visibility gives me about 12 to 14 days of outlook and so it's hard to see beyond that. Challenge right now is the softness is just so widespread whether it's general, industrial, commercial AC's pretty weak right now, cold chain is you watch the industry numbers right now, they are challenging. So it's hard to build a 2020 plan right now on the recovery of any sort, if it happens, that will be great. If it doesn't, what we're dialing in to do is improve margin without the growth and that's where all the focus is right now.

David Farr

Thank you very much, Steve. I appreciate. Who's next.

Operator

Yes, sir. That question will come from Nicole DeBlase of Deutsche Bank.

Nicole DeBlase

Yes. Thanks. Good afternoon, Dave.

David Farr

Good afternoon, Nicole.

Nicole DeBlase

So maybe just starting with a follow-on on the restructuring Slide. Let's say we do get like $200 million to $300 million cost of restructuring framework, should we think about that product like mostly dropping to the bottom line or would there be offset kind of going back to Julien's question, but in a little bit more detail.

David Farr

It's going to be, from our standpoint, typically what we're trying to target here, based on the final numbers, we're trying to get back to a record level of EBIT, which was a little bit over 19%. We're trying to get back to our record level. EBITDA, which was around 22.3 and 22.4. So some of the investment will be longer term, the payback of a little longer, but

I think that what we're looking at is a mixture of the long-term impact of short-term impact allow us to drive that profitability back those peak level margins with very moderate growth of underlying sales.

So I would say that historically when we look at it, we get back a dollar per dollar, it may be over or 18 months period. But it's typically a dollar for dollar and we'll let you know as we lay this out, there are going to be some capital investments, which will be a little longer because we're going to -- we need to build some best cost facilities as we consolidate some our manufacturing and that will be a little bit different payback. But it's definitely, we still always look for dollar plus for that type of investment and that's what we're seeing right now.

Nicole DeBlase

Okay. That's really helpful. Thanks. And then just one on the first quarter. Just if you could talk a little bit about what you're embedding in that $0.02 of operational performance accretion maybe like looking at underlying sales growth and expectations for margins in 1Q.

David Farr

Yes. So we're looking at basically about 1% underlying sales growth and we're looking at probably a couple of 10th operational margin improvement. The key issue here though is now that does include the 70 -- we're banking on a recovery on the cost investments for acceleration within the fourth quarter, if we get a decent mix, in different growth, hopefully, we'll have a little bit better margin improvement there , but in reality what we're really trying to get geared up for right now Nicole is we're trying to get the -- so it's fast and the cost reduction is done in this first fiscal quarter that's why we're trying to do $70 million, which will allow us to start getting some margin improvement underlying, as we get into that second and third quarter. So we're trying to get this game going faster. I think right now we're ahead of the wave. And I'd like to get a little bit further ahead of the wave and that's how you should feel about us right now.

Nicole DeBlase

Got it. Thanks. I'll pass along to someone else.

David Farr

Thank you very much Nicole. Hope to see you soon.

Operator

And next we have John Walsh of Credit Suisse.

John Walsh

Hi, good afternoon.

David Farr

Good afternoon, John.

John Walsh

I guess maybe a clarifying question first, so the $70 million of restructuring in the first quarter, is there any benefit associated from that restructuring in the current guidance construct of '20?

David Farr

No. So what we've built in is no, no benefit improvements on acceleration of restructuring. So when we -- as we start doing this and we lay out the plan, we will tell you what benefit cost is going to be coming in for the cost structure and what benefit we'll get from profits in this year, because we will by getting going in the first quarter, like we are doing right now, both Bob's business and corporate Lal's business, we will get some benefit from incremental EBIT dollars this fiscal year.

And so that's why we're pushing really hard to get as much done as possible in this first quarter. If it gets tougher and tougher, go into second, third quarter. So that's why we're trying to front load as much as possible. So the answer is no, we have not booked at any cost nor the benefits, which there will be benefits.

John Walsh

Okay. And then looking at the free cash flow, I mean obviously there is some moving pieces on the EPS guide, but free cash flow of $2.5 billion came in line with us in the street, I mean can you talk about some of the levers you have to pull to drive that $2.5 billion of performance and then expectations for that to grow going forward from here, I know you mentioned some capital investments may be to drive the larger restructuring program there?

David Farr

So from the standpoint of this next 12 months, I think the best lever we have is from an operational standpoint, can we get our inventory back. I think our inventory has a room to come down a little bit in 2020, as we slowed in the sales growth and our inventory levels did not come down as much as I thought they did do pretty well.

But they didn't come down as much, so I think we still have up to a $100 million inventory, we can get out of the Company in 2020. As you go forward, the key issue that is going to drive this is a continued working capital performance in Lal's business, as he continues to integrate his two recent big acquisitions. I think Bob's business is running pretty well tightly right now. I think you guys Tools business running pretty well to the first 12 months and then obviously if we drive our profit, profit drives that cash flow. So we're trying to drive free cash flow level back up, because what we're trying to get back to is, we're trying to get back to that $4 billion operating cash flow, which allows us to get spend the capital that we need up to $675 million to $700 million.

We will be also altering our capital spend as we get to understand the restructuring programs, we may have to spend a little bit more than $600 million, which is embedded in that forecast, we may have to spend $6.25 million, but we're also going to keep trying to push the operating cash flow, because I really do want to get our free cash flow to dividend payout back down toward 48, 47 as soon as possible in 2020 or early '21 and so there is a lot of things going on right now, but we're very focused on that cash because we know that's how we drive value.

John Walsh

Great. Thank you for the color. And thank you to Tim, for all the help.

David Farr

He been a decent guy. I tell you what we're going to find a good job for him. He has really done a yeoman's job the last 60 days and fortunately we'll -- I think well I've find a really good job to recast his skills. You can work out in the gym or something like that. Thanks, John.

Operator

Next to have Andrew Obin of Bank of America.

Andrew Obin

Yes. Good afternoon, gentlemen.

David Farr

Good afternoon, Andrew. I would say the gentle at this end is very loosely described, so you know, we're from the Midwest. I wouldn't call it gentlemen in the Midwest.

Andrew Obin

Alright, well, first, I do want to thank Tim for all the help. And I do have a question for Mr. Sharp.

Bob Sharp

You still in Suzhou or have you left the property? You're in China?

Andrew Obin

I am in China. Yes. Yes I am. We're very exciting.

David Farr

What city you're in?

Andrew Obin

I was in Shanghai yesterday, seeing our guys.

David Farr

Okay. Good.

Andrew Obin

Yesterday my time.

David Farr

Okay.

Andrew Obin

A just a question on lower end of CNRF guidance, what kind of macro scenarios and maybe we can walk what's happening in North America and Asia, would it take for you to sort of hit the lower end of your guidance, because you know comp seem to be fairly easy in Asia and to Steve Tusa's point that North American comps are not that hard either.

Bob Sharp

I think to hit the lower end of the scenario, Asia would have to keep going down and it's a little bit hard to tell right now. So I think you're getting a good read right now in the market, it doesn't feel like that's going to happen, but it's really hard to tell right now , month-to-month. And U.S. would have to we will be very difficult and that would probably be the broader industrial kind of a picture hitting the Pro Tools business, the commercial. It will be something more than just like a residential thing.

Andrew Obin

Got you. Thank you. And then question for Lal, just a couple of details, A do you include, have you gotten orders. I know that the Saudi facility wasn't Emerson facility, how much of the impact of the repairs was in Q4 and how much if any work you got for first half of next year and the second question, I think there was some talk about sort of a large, like there'll be one order slipping from Q4 into Q1. Is that correct. And are we going to see sort of any recovery from Q4 and Q1 or it's just steady rate from Q4 to Q1 on Automation Solutions?

Lal Karsanbhai

Sure, Andrew. So the Saudi facility was largely -- is largely and Emerson facility, both from a control system perspective instrumentation and valves, we saw repair activity, replacement activity through Q4 as the facility came back online very quickly within four weeks the facilities essentially back online. And, but the volume that we took in terms of our equipment to get it back online was not material to the quarter. Having said that, the modernizations that are going to have to take place within app CAG and their sister facility to get that facility modernized and safe with redundancies will have an impact to us. Those projects and are fully defined yet, Andrew, as we've gone through.

David Farr

There is still got be multi-million dollar.

Andrew Obin

You're going to be very large. As far as the KOB one order that slipped, we had talked about one specifically, we're still working that, it's very much in the work site. I'm trying to close it here with a team in Asia, Jamie in that team, here in November, it may slip into the very much outlooks into Q1.

David Farr

So, it did not happen -- still trying to get it. You'll see it, because it'll be a big order and pop.

Andrew Obin

Okay. Thank you, gentlemen.

David Farr

Again, gentlemen.

Andrew Obin

I'll still call you gentleman.

David Farr

Yes. Be safe. I know you're just a -- you're gentleman yourself, you be safe and get back to States soon. Okay.

Andrew Obin

Thanks.

Operator

Next we have, excuse me, Joe Ritchie of Goldman Sachs.

Joe Ritchie

Thanks. Good afternoon, everyone.

David Farr

Good afternoon, Joe.

Joe Ritchie

Thank you, Tim. Welcome, Pete.

David Farr

Your not in China, are you Joe? You not in China, are you?

Joe Ritchie

I am not. Nope. I'm in New York City. I think, I mean, just kind of sometime soon. So, but maybe just talk in China for a second and this potential trade impact Our guys have been writing about peak trade pain today and basically that being behind us. If we get, if we get -- if we move forward in sign Phase 1, how long do you think it will take to kind of rekick-start the CapEx engine to start seeing a little bit better growth rates across your business Dave?

David Farr

I think that I'll just take Bob's business first. I think there'll be a fairly positive impact pretty quickly for Bob just from a spending attitude standpoint. So I think that you would see a good business bounce in China. Bob has a lot of business in China, he is very strong there. So I think that way probably within a couple of months, I would say would bounce pretty quickly for him. The capital side, I think the CEOs would start, I would say within a quarter they start reevaluating. I think you start seeing some incremental spending starting to flow, a lot of work has been done, I mean, as you well know, Joe, we -- our book but not entered now our one but not numbers, how big Lal?

Lal Karsanbhai

Over $1 billion.

David Farr

Over $1 billion. So a lot of those projects are based around our China export type of market. And so I think that you would see some of those move pretty quickly. So I think that both Bob's and Lal's business would see a pretty good balance, we're obviously not assuming that right now because there is lot of uncertainty, but that would be one that would be the catalyst, as I said, that would create that second half recovery that would change us obviously to the plus two type of range and higher from that perspective, but I now be nice to see. In the meantime, we're focused on their cost. That's a good positive that would happen. The channel would move quickly as Bob said.

Joe Ritchie

I guess, Dave, then in that context, right, you guys have said call it like a flat guide for the year, your order trends are maybe kind of slightly above that, I guess in what scenario do things kind of get worse from where we are today?

David Farr

The scenario worse is that going back to my GFI numbers so that if this -- if we do not get an agreement with some improvement to get that, that tension out between the U.S. and China and it keeps grinding, I think you're going to see CEO's really continue to the curtail spending and that would drive obviously the GFI number down that would hurt us in the day-to-day spending. The other thing that would also that I'm really concerned about is the European economy does not see a recovery and the actions are trying to do with the new European leadership to try to get spending and investment going if this thing is still malaise in Europe that's a concern that we've built into that thing.

So that's we -- we don't see the catalyst yet that being triggered. We know what they are, but we don't see them being triggered if you're right Joe and what you guys are talking about and that we do see some realistic change in the discussions between the U.S. and China, we do get some realistic movement coming in Europe. That will be two positive catalysts that would change the momentum of the curve and move it upwards and obviously move that thing from zero to a positive number in growing from there. But until we see that, I mean, I want my guys to focus on getting the cost down and if we get it down fast enough and this recovery happens, then obviously we'll make pretty good leverage.

Joe Ritchie

Got it. That makes sense and maybe just one quick one for Bob. Bob and just thinking through the margin profile this quarter in your business, can you just kind of parse out what really drove the decrementals margins this quarter? What were kind of the key drivers among mixed pricing, what affected the business this quarter?

Bob Sharp

Right. Price-cost was positive for us as it was in the second half, turned a lot through the year. The deleverage of the sales and then with that you get some plant issues around productivity and turnover and stuff when you don't have the growth to work off of gets compounded as part of it and then as Tim said, for mix, Resi versus Commercial and AC and cold chain, the transport and some of the more profitable retail was off against other things. And then on the Pro Tools and the disclosures in the tools area very high margin product.

So it was -- a number of things kind of lined up in the wrong side of mix in the quarter in the. We don't -- we don't see that as any particular long-term trend or something like that, it's just sometimes the stars align and sometimes things work against us in this quarter was just bad -- things just did not line up well at all.

Joe Ritchie

Got you. Thank you all.

David Farr

Yes. Take care. Hope to see you soon.

Operator

Next we have Andrew Kaplowitz of Citi.

Andrew Kaplowitz

Good afternoon, guys.

David Farr

Good afternoon, Andrew.

Andrew Kaplowitz

Dave, so when you look at Asia, Middle East, Africa Automation Solutions, the growth was 10% in Q4, which did accelerate versus Q3. You mentioned it briefly, but it does seem like it reaccelerated here, so what new markets are contributing to the reacceleration and is your confidence level increasing that China is still going to grow 5% to 8% or 6% to 8% in FY '20 in Automation Solutions.

David Farr

I think that from our perspective we saw some, some very good international growth in late in the second half of the year, as it was really good to see. I think the opportunities in China are pretty still significant, as they continue to invest in technologies in areas that are allowing them to become more self-efficient. They are clearly investing in next generation digital technologies and so we're seeing that, that's a positive.

So we had a very good year last year and the year before in China, and so I think that we still feel very confident we're going to see sales in the orders in this 5% to 10% range. So, I think we still see that, now going back to I think Joe's questions if we did get some kind of settlement and the relationships did improve, I think that will be a big positive to us, because of our presence in the quick investment opportunity, but we've got to see that, because it's just something, it's soured and we need to obviously fix that relationship.

If you look at the Middle East, I think the Middle East has huge opportunities, what concerns me about the Middle East is primarily is the fact that the geopolitical the turmoil, the other actions that are going on there, I wouldn't call it war, but the skirmishes that are going on and so I'm very concerned about this period right now and that's why I'm probably more cautious than the average person relative to the Middle East, because I'm really concerned about all the activity under way in the Middle East and the concern that I have around, as that disrupt the projects and that standpoint.

Now, the bookings would say not, but I am a little bit concerned, so I'm little bit cautious in those two marketplaces and the other one I would say is Latin America. We've had a good run, and the question is, does the whole Argentina thing, the Brazilian thing and the lack of money, does that stall saw as we go into 2020. So, Lal, why don't you give your view of that.

Lal Karsanbhai

Yes. Thanks, David. The China team did a phenomenal job serving what is for us a larger than building dollar market with very relevant customers who are willing and using our technology today and they want the latest and greatest technology, whether it's digital transformation, control systems, final controlled or instrument devices. So phenomenal job by the team to drive mid to low teens type of growth in China this year.

And as David said, our expectation today given the environment is in that mid single-digit type of growth, 5 to 10 in that range would -- based on what we see in this space today. The only one I would add, David, I think you're right on, on the Middle East and Africa, I think Latin America is a concern right now given, the skirmishes and the unrest we have just basically across the continent. We had a phenomenal, a two-year run in Latin America and we're a little bit -- we're going to watch that one very carefully as we go forward.

David Farr

Good. Thanks.

Andrew Kaplowitz

Thanks for that guys. And then just staying with China actually in the Asian heating and cooling market, it does seem like the issues there for you guys have dragged on a bit longer than you expected. Is there a competitive issue there at all? And then you do a much easier comparisons coming up in Q1 as I remember correctly, China, heating, cooling fell off quite significantly in Q1 of this year? So would you expect Asian sales to shift now to positive growth despite continuing with the markets?

Bob Sharp

Yes. It was improving. Like we said, it was down 30, actually in the first quarter last year and then it improved and getting pretty flat, but in Q4, it was down 9% again. So it's still been bouncing around a bit. We do have an easier comparison in Q1 October data point was solid. So you could see a scenario where China is positive in Q1. And again, the question is what kind of stability that has and keeps throughout the year is a little bit hard to tell right now.

David Farr

I mean it has not been a competitive issue. I think Bob...

Bob Sharp

Yes. Sorry, I missed that.

David Farr

It's they don't have the money.

Bob Sharp

The mix and from the standpoint of the driving right now with the commercial side of the business, it's frankly not Chinese competition. It's pretty specific competition that we know in quite in detail and we're doing well there, especially with some new 25 -- product layout and then our cold chain as well. So no, we don't see it as a competitive thing. Heating really fell away the heat pumps and stuff, there's still the green air policy and stuff like that, but I wouldn't say it was as actively being worked for a while, and as that funding and activity plays out, if that recovers, that's also a big part of the story.

David Farr

I think if you think back for the people on the phone and Andrew, you talk about, I think there are a couple of big wildcard you guys -- it's China clearly -- China could be a very strong play for both businesses this year, it could be a dud, but it could be a very positive. If there is -- if favorable discussions happen between the two Presidents of the country, and we do come to some kind of terms of initial phase agreement that would create a positive mode, both in China and also in the U.S. for us.

And so those are two wildcard that I see that had the biggest impact potential for us in the upside, as we look at the Company today and that's why we're trying to work as quickly as possible on the cost because if we get this thing gone, we can get that cost down, that'll be a nice bounce for us, but those are the two wild cards, you guys are focusing on pretty hard and the questions and I agree with you on both of them.

Andrew Kaplowitz

Thanks guys. I appreciate it and Tim, appreciate all the help.

David Farr

Okay. Thank you, Andrew.

Operator

Next we have Robert McCarthy of Stephens.

Robert McCarthy

Good afternoon, everyone.

David Farr

Good afternoon, Rob.

Robert McCarthy

Thanks again.

David Farr

Did you ever get out of that taxi I saw in -- did you ever get out of that taxi?

Robert McCarthy

Eventually. Yes. Eventually, I did.

David Farr

You were banging the window and kept saying, help me, help me.

Robert McCarthy

Absolutely.

David Farr

You're from some place not from the East Coast, you can get confused.

Robert McCarthy

Yes. I just wanted to honor the quiet period. That's all. You look like you were in a hurry and you're wearing the suit and got yourself shaving, I do not know, you were looking little nervous.

David Farr

You got it.

Robert McCarthy

All right. Okay. In any event, thanks Tim for everything. Really appreciate it. I think a couple of questions. First, if Bob wouldn't mind just talking a little bit longer-term about the HVAC markets from what he is seeing, clearly at a competitor conference this week, some admittedly smaller cap players have been talking about perhaps a flattening out of trends, particularly in housing or housing related consumer replacement like HVAC water heaters et cetera, where you could be seeing some pronounced weakness that could point to kind of end or pause in the echo boom of housing that we saw in late 2000 timeframe.

I didn't know from what Bob seeing over the longer term and the installed base of what he deals with the players he serves, whether there is some concern that we could be seeing a longer-term secular step down and and what has been a very strong market over the past call it 10 years.

Bob Sharp

Yes. I'd say, I think for 2020, our outlook on the U.S. market is quite modest and in the commercial probably a little bit of different dynamics within the residential and the commercial side, you see it now, I think I just saw that were for last week, the average person hanging on their health 13 years now, so they're not turning over as much which triggers a lot of the remodels, and 80 or so percent of the HVAC sales are on replacement as opposed to the new stuff.

So on the housing starts has been lumbering along in the low-1's, and we don't really see anything different about that. On the replacement cycle..

David Farr

Yes. Let me give it. Bob, you know I've been involved in this business for longer than Bob has here. And I would say there are a couple of things going on. I think there is a fundamental flattening and one of my concerns is these guys have a deal in its issue, it's a cost of the new efficiency standards and the fact that people are now replace units or repair units versus replacement because to avoid the efficiencies change-ups in the price point of those units.

So this trend has been going on for some time. I personally believe and as Bob's company structure thing, I think this is going to continue. And there's not going to unit growth, you're going to be price growth as a dollar value to growth, and that's what we're going to see as you guys go forward with your new replacement and that's what's going to happen here is to make technology value play because I think the cost of the new efficiency units, the refrigerants are going up and it drives down the underlying unit volume and that's what we did see for quite some time.

And I think that's going to continue to your point.

Bob Sharp

As we move into the next refrigerant standards for 2023 with the '18 of the mildly flammable that's going to also require some mitigating stuff on the systems, because of the flammability and they'll probably prolong some of the place or...

David Farr

I think people are looking to replace and 20 years -- I think they're going to try to drive these units as long as possible. To your point, I think that's what's going to happen. I mean, between the refrigerants and efficiencies. I think people are going to drive a lot of the news, as long as possible and that's going to drive our unit. Therefore, you're going to make out and costing to make up and price points.

Robert McCarthy

Okay. Now, thank you for that color. That's very helpful. I think the only other question I would have is just in terms of the free cash flow, I think, if my math is correct, which is often wrong, we're talking about $4 of free cash flow for next year and from that standpoint, what do you think you can drive it in the out-years and obviously given what's occurred in terms of the global economic environment and other issues, I don't think we need to talk about the target of 450 in earnings per se for fiscal '21, whether that's on or off the table, I think more importantly, what could we be expecting to see in the kind of that free cash flow number in the out years? What do you think it could compound that and maybe, and maybe just talking to the segment leaders, what can they can kind of tweak up or control, whether it's through the continued Final Control and Valves integration or other parts of the business to improve cash going forward, so that you think you can continue to compound here and a pretty higher rate because a key differentiator to the story is clearly your free cash flow conversion.

David Farr

So I'm going to -- we're going to buy on the same because these are things that as we look at the profitability as we change in our capital mix, as we do the capital allocation, Rob as we look at the capital investments and the change in the structure of the Company that's going to have an altering to the free cash flow. So we'll make sure that we will cover that at the February meeting because that is one of our objectives can we -- we as a company has always been a very good cash flow generator.

The question is, as we drive our margins as we rebase and we look at excess capital employed in the Company, we take that out, can we make that capital, our cash flow number even better. So I'm going to push on that until we finish our work here, because that's one of the outcomes of the work we're doing and that is clearly one of our objectives because we believe strongly cash will drive the value of our company and also allows us to give money back to our shareholders.

Robert McCarthy

I'll leave it there. Thank you.

David Farr

Thank you very much, Rob. All the best to you. Be safe.

Operator

And next we have Jeff Sprague of Vertical Research Partners.

Jeff Sprague

Thank you. Good afternoon, everyone.

David Farr

Hey Jeff. Are you in some place. Please tells you're in China, you're in Antarctica, where are you?

Jeff Sprague

I mean the city that works, Stamford, Connecticut.

David Farr

The city that taxes or did you work, I can't even say it's taxes or works -- go ahead. Go for it Jeff.

Jeff Sprague

All right. Two things. So Dave, the $0.08 of EPS growth for for 2020 of the operational improvement that's effectively I guess on zero organic growth. Right?

David Farr

Correct. Correct.

Jeff Sprague

So implicitly that's restructuring savings, so that $0.08 is $65 million bucks or so is that carry over from 2019 actions you said earlier you have no benefit from Q1 in your guide, but it would seem like perhaps there is some restructuring coming through?

David Farr

Yes. That means there is a couple of things going on there. It does the carryover for the second half, because we accelerated restructuring in the second half of the year, that's helping us in a big way and will see that from the incremental margins. Two, the price cost has definitely helped us in this scenario, a little bit better, more favorable from a price cost that's helping us. And we clearly look at the different type of mix and we had some tough mix of second half, so we're basically we always go back to normal mix, we don't plan on same top mix. So I think that those are three things but clearly a biggest chunk of that would be the restructuring benefits we got from the acceleration from June, July, August, September and I would say that's the biggest benefit.

And then when we flow out the restructure in the first quarter, we'll tell you what that number is, we'll start laying out the benefits and you'll start seeing those incremental benefits come forward in the second half of 2020.

Jeff Sprague

But what should we expect Dave, you haven't put them in your guide, but there should be some payback from that $70 million and...

David Farr

Yes. There is going to be -- Yes. There will be some payback and I mean I don't think it's going to dollar for dollar because it's -- because we are not going full year, but I would say at least $0.50 per dollar would be estimate right now in this year.

Jeff Sprague

And then, just thinking -- right in this year. And then just thinking about what we might hear in February. So it sounds like you have full Board approval for this restructuring right you -- you know what you need to do. You're going to do $70 million in the first quarter, that's, call it 30% of a grand total of $250 million or so. So you're coming out of the gate with apparently Board approval and company buy in on the whole restructuring so putting aside kind of portfolio questions, I mean, is there some further deeper discussion on cost or other metrics or regardless of the portfolio changes or not, this is -- this is the restructuring number?

David Farr

So I do not have full Board approval yet on everything we're trying to do what I told the Board is that we are still working, the broad plans at each of the businesses are that first passes. I also have some initial work looking at from the corporate standpoint and what we can do at the corporate, but it's not done yet. So what we -- what I told the Board is there is $70 million of activity, we can do pretty quickly this quarter and I want to get on with it and they need a trust me as a longtime CEO as a leader of this company that we are not doing things that are damaging the Company, going back to what the earlier question.

So I do not have full Board approval on the total plan, but what I push these guys pretty hard is what can we get done in the first couple of months of this year to really gives us some headroom and some flexibility if things get sloppy. And so that's what the $70 million is and you're right, I push pretty hard, but the Board does trust me that I'm not going to do some stupid and then they'll see the whole review of all the plans as we go forward here. So they have not approved it, they is allowed me to take a big jump and jump on the first start here based on my credibility and leadership of running Emerson for the last 19 plus years. So that's what it looks like Jeff.

Jeff Sprague

Yes. So that makes sense. And so that would then mean that if you do the -- the full $250 million or $300 million, there is a heavier structural lift that these actions would clearly carry into 2021, you would not be able to get all that stuff, started in 2020.

David Farr

What the stuff I'm doing -- the stuff up front right now are very quick. These are very quick actions both Bob, Lal, and we are corporate doing. So the stuff that we're trying to do right now, it will be quicker and faster payback and the really structural things will take longer in the second half of the year and more into '21. So you saw what I -- what I ask the guys is find me the things that we could get on to very quickly that we -- that make a lot of sense from that we would do normally, but let's go as quickly as possible and it gives me some time to deal with the longer structural issues and how we go about looking at that. We want to prove -- I want the Board approval on those things.

And so I think that's how we're looking at it for the first 3, 4, 5 months, I'm looking at quick things we can do by going after on the quick cost structures, which don't really take a lot of of a Board approval process from the standpoint of going forward. So that's what we're look at. I'm trying to get things quicker that give us a little headroom, from the standpoint of what's going on in the economy.

Jeff Sprague

Great. Thanks for the color and good luck.

David Farr

All the best to you. Thank you very much, Jeff.

Operator

Next we have Josh Pokrzywinski of Morgan Stanley.

Josh Pokrzywinski

Hi. Good afternoon, guys.

David Farr

Hi, Josh, you're going to be my last guy here and I apologize everybody else, but you know I have the longer questions, I have more people on the phone today, so I apologize that I will work very, very hard to get the rest of people next time or working around, but we've been already past an hour and 20 minutes.

So, but I want Josh, you got your three questions. Take your time. Your closing it . You're staying between all of us from getting a drink. Don't screw it up now. Come on.

Josh Pokrzywinski

Well, I'd have more time if Rob McCarthy wasn't such a storyteller, but we'll If you say anyway.

Just on the restructuring, if you could kind of help us with maybe the framework that you're adopting or as you're bring in some of these external folks to work -- to look at the organization, is it more kind of looking at some of the structural costs, things like G&A, where maybe there duplicate functions or is it more on trying to benchmark businesses to say like Final Control could take it to the next level, we can compare that to a competitor or something like that. Is there a specific track that this is going down or is it a little bit of all the above?

David Farr

It's more of we're looking at G&A expenses that may be that we don't need to do and we have duplication. We're looking at things that both the two businesses do and the corporate do are the things that we do from a frequency standpoint and in the process, we're sort of overdoing them and maybe we're spending a little bit more money, as we shrunk the Company into two platforms and we trade off back and forth, where could we go after from a G&A standpoint.

The structure stuff that we're working on very much is around the structure between the individual businesses, our facilities and maybe where we have too much capacity to make facilities or maybe where we have too much overlap from an organization standpoint, we may want to put organizations together. So we're looking at more of a structural from that perspective. And then we're looking at the cost structures in between all the G&As benchmarking, what we do as a company and what other companies do.

And we make sure that we are -- we consider ourselves best in class. But are we doing things too much and can we look at cost, we can take out. I mean, fundamentally we run very high levels of profitability as I pointed out, but I think we can run higher levels of profitability and how do we make sure we do that without jeopardizing the control and the discipline, our planning process in the credit billion and that we have as a company. So, those are things we're looking at, Josh.

Josh Pokrzywinski

Got it. That's helpful. And then shifting over to the demand side. And Dave, the last time we had a slowdown, you had a big set of customers in oil and gas to kind of learn capital discipline for the first time. So maybe there are levers that got pulled that wouldn't get pulled again, how would you compare some of the decisions are customers are making around timing are curtailing spending and kind of how rational those seem in the current environment or how sustainable some of those decisions are?

David Farr

Well, first, Josh, this cycle just barely got started and I don't think there has been any level of excess spending or capital that we've seen. From my perspective, I think they've been very rational, what they're doing right now is they're spending more money on short-term paybacks, you saw the KOB 3 to KOB 2. So I think there's a lot more discipline within this segment, I'll let Lal talk here in a second.

But I think it's a better process for us and if they get some clarity around what's going to happen in China, some clarity what the -- let's say the trade discussions are going to be, I think you'll see some of that capital flow out and I know they have pressures on them relative to their capital allocation, but I also think they have the capital flexibility to invest for the future and so I think the disciplined standpoint has been much better here in the last 2 or 3 years and this cycle has been truncated and pushed down and I think it could pop back up in a nice way. So, Lal, anything you want to add there?

Lal Karsanbhai

No. I think that's well said David. The discipline around the capital is there, the discipline around the operational dollars there as well. But ultimately the plants have to run safely, the fuels have to run safely, and there is a degree of investment that goes along with that and $118 billion type of installed base that we do have leads us to gain -- continue to gain customer relevance and trust as we go through the slower periods of time.

David Farr

I want to thank everybody. Tim is not going to go away. He'll be still with us. I think he'll still be with us in early February. He may be in a transition mode, but he is not going anywhere anytime soon. So, you guys at least have a chance to be nice to him one more time. I wouldn't overdo it, but I appreciate everyone's -- I appreciate everyone's patience and I also want to thank all my shareholders and the sell side analysts for giving me the time to talk about issues what's going on, what you think about the Company and what the Board should be thinking about those are very, very important inputs to us and the Board truly appreciate them, and they were summarized by Tim, Mark, and myself and they got them, and they read them. And I want to thank everybody and I will look forward to seeing you guys real soon. Thank you. Bye.

Operator

And we thank you sir also and to the rest of the management team for your time today. Again, the conference call is now concluded. At this time, you may disconnect your lines. Thank you again everyone. Take care and have a great day.