Ingersoll-Rand (IR) Earnings Report: Q1 2015 Conference Call Transcript

The following Ingersoll-Rand conference call took place on April 23, 2015, 10:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Joe Fimbianti; Ingersoll-Rand Co. Ltd.; Director of IR
- Mike Lamach; Ingersoll-Rand Co. Ltd.; Chairman & CEO
- Sue Carter; Ingersoll-Rand Co. Ltd.; SVP & CFO

Other Participants

- Nigel Coe; Morgan Stanley; Analyst
- Mark Douglass; Longbow Research; Analyst
- Deane Dray; RBC Capital Markets; Analyst
- Jeffrey Sprague; Vertical Research Partners; Analyst
- Robert McCarthy; Stifel Nicolaus; Analyst
- Julian Mitchell; Credit Suisse; Analyst
- David Raso; Evercore ISI; Analyst
- Joe Ritchie; Goldman Sachs; Analyst
- Shannon OCallaghan; UBS; Analyst
- Steve Winoker; Sanford C. Bernstein & Company Inc.; Analyst
- Steve Tusa; JPMorgan; Analyst
- Robert Barry; Susquehanna Financial Group / SIG; Analyst
- Jeff Hammond; KeyBanc; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Good day, ladies and gentlemen, and welcome to the Ingersoll-Rand first-quarter 2015 earnings conference call.

(Operator Instructions)

As a reminder, this call is being recorded. I would now like to introduce your host for today's conference, Joe Fimbianti, Director of Investor Relations. Please go ahead, sir.

Joe Fimbianti (Director of IR):

Thank you, Danielle. Good morning, welcome to Ingersoll-Rand's first-quarter 2015 conference call. We released earnings at 7.00AM this morning and the release is posted on our website.

We will be broadcasting, in addition to this phone call, through our website at IngersollRand.com where you will find the slide presentation that we will be using this morning for the call and this call will also be recorded and archived on our website.

If you would, please go to slide 2, which is our Safe Harbor statement. 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 the federal securities laws. Please see our SEC filings for descriptions of some of the factors that may cause our actual results to vary materially from our anticipated results.

This release also includes non-GAAP measures which are explained in our financial tables to our news release. With me this morning on the call are Mike Lamach, Chairman and CEO; and Sue Carter, Senior Vice President and CFO. So if you will please turn to slide 3, I will turn the call over to Mike. Mike?

Mike Lamach (Chairman & CEO):

Thank you, Joe. Good morning, and thanks for joining us. In the first quarter, adjusted earnings per share was $0.38, an increase of 31% versus last year's quarter. We closed two acquisitions in the quarter, the acquisition of the Cameron Centrifugal Compression division closed on January 1, so results were included for the entire quarter.

We also closed the acquisition of Frigoblock in early March so that had a very minimal impact on the quarter given that less than one month of results were reported. Both integrations are going very well. Cameron Compressor achieved our forecast for bookings, revenue, and operating income. We are seeing some early traction on cross-selling and synergies and we expect continued progress for the balance of 2015.

Currency had a significant impact throughout the results so in our comments today, we will mainly focus on organic growth, which excludes currency and acquisitions. But you can get a better view of end market trends. In the first quarter, we saw solid organic revenue of growth of 8% led by strength in the US and Europe, particularly in the climate segment.

Border rates remained healthy in the first quarter of 5%, excluding currency and acquisitions. Adjusted operating margins increased 40 basis points and increased 100 basis points excluding the impact of currency and bringing Cameron results into our financial statements for the first time. Adjusted EPS for the quarter was $0.07 above our adjusted EPS guidance midpoint of $0.31. The improvement primarily came from higher-than-expected volume, mainly in North America, and good cost control and execution to our plan.

Foreign exchange translation, negatively impacted the quarter by about $0.01 compared with guidance; however, this was more than offset by FX gains recorded in other income. Now, Sue will walk you through the first quarter in more detail and I will come back to take you through our outlook.

Sue Carter (SVP & CFO):

Thank you, Mike. We are very pleased with our performance and our execution in Q1, and as Mike talked about, you are going to see a lot of moving pieces with currency and purchase accounting. And we are tried to provide you with a lot of detail to facilitate your understanding of the quarter in both the slides and in our comment.

So if you would go to slide 4, orders for the first quarter of 2015 were up 3% on a reported basis and up 7% excluding currency. Orders were up 5% excluding both FX and acquisitions. Climate orders were up 2% and up 6% excluding currency.

Global commercial HVAC bookings were up mid single digits on a reported basis, and by high single digits ex-currency. Transport orders were up low single digits, and up high single digits ex-currency.

Organically, Thermo King had strong order growth in North America and high teens growth in Europe. Orders in the industrial segment were up 3% on a reported basis, and up 9% excluding currency.

Orders for industrial were up 2% excluding currency and acquisitions. We saw organic orders increase by low single digits in air and industrial products, and improved by high single digits in club car.

So if you would go to slide 5, here is a look at the revenue trends by segment and region. The top half of the chart shows revenue change for each segment. For the total company, first quarter revenues were up 6% versus last year on a reported basis, and up 8% on an organic basis, which excludes both foreign exchange and acquisitions.

Climate revenues increased 6% on a reported basis, and 9% ex-currency. Commercial HVAC was up high single digits and transport revenues were up mid teens, both ex-currency. Residential HVAC revenues were up high single digits. Industrial revenues were up 7% on a reported basis. Up 13% excluding currency and up 4% excluding currency and acquisitions.

And I will give you more color on each segment in the next few slides. The bottom chart shows revenue change on a geographic basis with and without currency. Excluding currency, revenues were up 10% in the Americas, 22% in Europe, Middle East, and Africa, led by strong HVAC performance, and Asia was down 3%. If you back out acquisitions as well as foreign exchange, the primary change is in the Americas, which would be up 8%.

Please go to slide 6, this chart shows the change in operating margin from first quarter 2014 of 5.7% to first quarter 2015 which was 5.9%. Consistent with prior quarters, this is shown on a reported basis, and we have spiked out the restructuring to get you to adjusted margins as well. Volume, mix and foreign exchange collectively were 40 basis points positive versus prior year. Price was positive, but was slightly less than direct material inflation.

Pricing was most competitive outside of North America. Productivity versus other inflation was positive 80 basis points, driven by strong productivity in the quarter. Productivity favorability was in direct materials, G&A, and solid execution, including the third phase of our ERP implementation in the first week of April. Year-over-year investments in other items were 80 basis points. This was the first quarter which included results from Cameron, and as expected, impacted margins by 50 basis points due to inventory step-up, and intangible amortization.

In the box, you can see 60 basis points of head wind from investments and 30 basis points positive from lower restructuring costs. In the gray box at the top of the page, overall leverage, on an adjusted basis, was 12%. Backing out currency and acquisition results, leverage was approximately 20%.

Please go to slide 7, the climate segment includes train commercial and residential HVAC and Thermo King transport refrigeration. Total revenues for the first quarter were $2.2 billion. That is up 6% versus last year on a reported basis, and up 9% ex-currency.

Global commercial HVAC orders were up mid single digits on a reported basis, and up high single digits ex-currency. Organic orders were up in all geographic regions with notable strength in North America and Europe. Trains, commercial HVAC first quarter reported revenues were up mid single digits and up by high single digits ex-currency.

Commercial HVAC equipment revenues and HVAC parts, services, and solutions revenue were both up high single digits versus prior year ex-currency. We saw year-over-year gains in both applied and unitary ducted and ductless equipment.

Thermo King reported orders were up low single digits and high single digits versus 2014's first quarter ex-currency. Organic orders increased in all regions except Latin America. Thermo King reported revenues were up by high single digits and up by mid teens ex-currency with strong gains in North America truck and trailer and auxiliary power units. In Europe, organic revenues were up high single digits.

Residential HVAC revenues were up high single digits with volume gains in all major residential product categories as well as in light commercial products, which were up low double digits for the quarter. The adjusted operating margin for climate was 7% in the quarter, 40 basis points higher than first quarter 2014, due to volume and productivity, partially offset by inflation, currency, and higher investment spending.

Please go to slide 8, first quarter revenues for the industrial segment were $729 million, up 7% on a reported basis, and up 4% organically which excludes the Cameron acquisition and currency. Air systems and services, power tools, fluid management and material management, organic revenues and orders were both up low single digits versus last year. Organic revenues in North America were up low single digits while revenues in overseas markets were flat.

Club Car organic revenues in the quarter were up high teens from improved sales of golf cars and utility vehicles. Organic orders were up high single digits versus prior year. Industrial's adjusted operating margin of 11.9% was slightly down compared with last year as we were in the early days of the Cameron acquisition, including heavy purchase accounting impacts and negative currencies.

For the segment, price offset direct material inflation and productivity offset other inflation in the quarter. We achieved our Q1 plan for the Cameron acquisition, and the business will continue to add benefits as we continue the integration process. Industrial's organic operating margin at constant currency was 13.9% for Q1, an increase of 180 basis points over prior year.

Please go to slide 9, for the first quarter, working capital as a percentage of revenue was 6.3%. The increase versus prior year is primarily inventory. This includes some incremental inventory related to the regional standards change in residential HVAC, and additionally, we have intentionally increased stocked inventory levels of key component assembles in order to ensure availabilities of supply as we enter the prime selling season for commercial and residential HVAC products.

We had good collections in the quarter with our day sales outstanding and days payable outstanding both improving over the prior year. Our balance sheet remained very strong. We have no debt maturities this year, given the financing we did last October, and the early retirement of the 2015 note. Our cash balance is at normal levels.

We expect free cash flow in 2015 to be in the range of $950 million to $1 billion. Before I conclude, you saw that we devalued our assets in Venezuela in the first quarter, due to the ongoing decline of the Venezuelan currency. This charge was recorded in other income and expense, and we have adjusted it out of earnings per share, given its unusual nature. And with that, I will turn it back to Mike to take you through our guidance.

Mike Lamach (Chairman & CEO):

Great, Sue. Thank you. Please go to slide 10. Overall, our forecast has not changed materially since our last call in January. North American institutional markets were up in the first quarter and we expect to have a positive year, albeit it at a more moderate pace than the current dodge forecast.

We also continue to see growth in commercial and industrial buildings and retrofit. Based on this week's backed mid single digit growth for 2015 in North American commercial HVAC markets, we expect Latin America and Asia and European and middle HVAC markets in the aggregate to be up low to mid single digits, constant currency, but flat to down after considering currency. We expect North American transport markets to be up mid single digits in 2015 and European markets to be down, including FX.

We expect residential HVAC industry motor bearing unit shipments for the year to be up low to mid single digits and revenue should be up mid to high single digits due to favorable mix. We expect industrial markets to be up low to mid single digits. Golf markets are expected to be up low single digits.

Aggregating those market backdrops, we expect our reported revenues for full-year 2015 to be up 4% to 5%, versus 2014. Overall, foreign exchange will be a headwind of about 3 percentage points, and we expect Cameron's Centrifugalsen business to add 3 points for the year, so for organic growth, excluding foreign exchange, we end up back at the 4% to 5% range.

Translating that to our full-year outlook by segment, we expect climate revenues to be up 2% to 3% on a reported basis and 4% to 5% excluding currency. For the industrial segment, revenues are forecast to be in the range of up 13% to 14% on a reported basis and 4% to 5% excluding Cameron and foreign exchange.

Industrial has a higher proportion of revenues outside of the US than climate, so industrial experience is more [intact] from FX as compared to climate. For operating margins, we expect climate margins to be in the range of 12.5% to 13.5%. We expect industrial margins, including Cameron operations, and amortization, excluding the impact of the inventory step-up, to be 14.5% to 15.5%.

The inventory step-up will be reported in the first and second quarters as about $12 million per quarter. Since it's non-cash and isolated to those two quarters we felt it was more representative of ongoing earnings to spike out the step-up. If you remove the Cameron impact, the legacy industrial segment has operating leverage over 50%.

Let's go to slide 11. Transitioning to earnings, I reported earnings per share guidance ranges $3.42 to $3.60. Excluding the Cameron inventory step-up, restructuring, and the Venezuelan currency devaluation, the range is $3.66 to $3.81, an increase of 10% to 14%, versus 2014.

When you exclude the impact of bringing Cameron revenue and earnings in for the year, and currency, the legacy company leverages at approximately 30%, and including acquisitions and currency, we should be in the 25% range. The $0.07 per share out performance for the first quarter largely offset the additional currency headwinds for the strengthening of the dollar against overseas currencies in the quarter. For example, we built our original guidance at a Euro rate of $1.16 and our current forecast is at $1.08.

Just as a reminder, the information we gave you last quarter, to give you some simple math to gauge our sensitivity to currency movements, a $0.01 move [it in] the Euro means about a penny in earnings. In all currencies move 1%, versus the dollar, that would be about $0.02 of earnings.

To focus on the second quarter guidance, see the right-hand column on the chart. Second quarter 2015 revenues are forecast to be up 4% to 5% on a reported basis. You can see the currency and acquisition impact on the slide.

Reported second quarter earnings per share are forecast to be $1.14 to $1.18. The inventory step-up all hits in the first and second quarters and impacts the second quarter by $0.03. We also expect about $0.01 of restructuring costs, adding these back to get to an adjusted basis. The EPS range if then of $1.18 to $1.22. We have provided EPS ranges for the second quarter in the appendix to give you the walk from year to year.

For the full-year 2015, we expect to generate free cash flow of $950 million to $1 billion, which is at our long-term target of 100% of net income. We increased the dividend by 16% to be consistent with the payout ratio in the peer range. We also utilized EUR100 million of cash to pay for Frigoblock. We anticipate a minimum of $250 million of spending for share repurchase which will offset dilution from equity issuances.

That leaves about $350 million of cash that will be put to either value accretive acquisitions or share repurchase. We have a pipeline of acquisition opportunities related to our core businesses, and we weigh those risk adjusted opportunities against buyback in terms of returns and shareholder value.

Our strategies for growth and operational excellence have delivered a multi-year trend of excellent operating leverage, margin and earnings improvement. Our focus is to continue to grow earnings cash flow through further implementation of those strategies. We have practically worked to deliver productivity and make prudent investments for the future. We continue to execute a consistent value maximizing capital allocation program.

In closing, we have given you a lot of data, and analysis on our operations this morning, there are a lot of moving parts to this year's numbers and it is likely to continue as we go through the year. Filtering out all the noise, I hope it is obvious that our overall business fundamentals are strong. Our investments are fueling our revenue growth. And our productivity improvements are on plan.

Our two new acquisitions are on forecast. And we believe we have purchased two very sound businesses. There is still a lot of work to do but I am very pleased that our steady operations and improvements and the growing maturity in our operations. Proud of the progress we have made, the results we have delivered and believe we are well positioned to 2015 as well as for the future. With that, Sue and I will be happy to take your questions. Danielle, I will turn it over to you.

QUESTIONS & ANSWERS

Operator:

Thank you.

(Operator Instructions)

Our first question comes from Nigel Coe from Morgan Stanley . Your line is now open. Please go ahead.

Nigel Coe (Analyst - Morgan Stanley):

Thanks, good morning, Mike and Sue. Just wanted to just kick off first of all with the margin bridge from the slides and a little bit surprised to see 20 bips impact from price [rolls] this quarter.

Especially given the [saition] we have seen in the raw materials. I'm just wondering, can you maybe make some commentary on price and why that was negative.

Mike Lamach (Chairman & CEO):

Nigel, we had positive price in the quarter. We had a little bit of carryover material inflation just due to some of the assembles that we are working on. But essentially the price would come into the Asian market, particularly China, a bit into Latin America which, really in the last quarter or two, those marks have struggled.

And we've gotten some local competitors with some capacity to utilize, and so that has been a bit more pressure there. We also had a bit of a rebate timing from Q4 to Q1, and if you add that back to Q1, and normalize it, we were pretty close to being flat. Which it is 20 basis points less than what we had hoped for, but it was fairly flat.

Nigel Coe (Analyst - Morgan Stanley):

Are we still looking for about 23 bips benefit for the full year?

Mike Lamach (Chairman & CEO):

We are challenging ourselves to do that. That is probably one of the challenge points in the forecast. But our plan, the road maps we are building, the counter measures that we've got to realize price would have us doing about 20, 30 bips of price, in material inflation gap.

Operator:

Thank you. And your next question comes from Mark Douglass from Longbow Research. Your line is now open. Please go ahead.

Mark Douglass (Analyst - Longbow Research):

Hi, good morning.

Mike Lamach (Chairman & CEO):

Good morning.

Mark Douglass (Analyst - Longbow Research):

Is there a little bit of conservatism in guidance on the organic growth expectations? I suppose some of that is because 1Q is really seasonally weak, don't want to read too much into the year. But your trends seem pretty good, and certainly outpacing the 4% to 5% organic growth expectations.

Mike Lamach (Chairman & CEO):

Yes, the optimism in the quarter was the strong growth, but as you pointed out it is seasonally such an insignificant quarter to the full year for us that we typically go back and fine tune in July and we will do that again this year.

But your question -- Nigel's earlier question, where we might see potentially some upside to volume, mix was not particularly favorable, in the quarter, for us. Currency, it is still quite a bit of headwind, if you look at the Euro at $1.08, and currencies where they are today, it is about $0.11 of headwind. We offset about $0.07 in the first quarter but we have more room to work for the balance of the year.

And then again the pricing question, we've got a more aggressive view around pricing for the balance of the year. So you net it all out, I think it nets out to a balanced view on guidance, but specifically, on your question, if we were to see stronger markets, by July, we would probably make a little higher call at that point in time.

Mark Douglass (Analyst - Longbow Research):

Okay. And then you mentioned industrial [hits] better than 50% incremental margin in the legacy business. Can you describe what is really driving such strong incremental leverage?

Sue Carter (SVP & CFO):

Well, it goes back to, Mark, what I talked about, when I talked about the segment, is that if you -- they have a higher impact from currency, right? So if you take that out, that is a piece of it. And then if you take out the Cameron acquisition that it's in its early days and it's got all that purchase accounting, the business or the segment itself actually had positive price versus direct material inflation.

They actually had productivity that offset inflation, and so they actually had a very nice quarter in terms of operational performance that underlie the basics of that. So -- and also investments were in line with the revenue percentage, in the first quarter of 2015. So you take out some of that noise that we talked about, they actually leverage very, very well for the quarter.

Mike Lamach (Chairman & CEO):

Club Car did a great job, too, doing what we expected against a very easy comp from last year, but Club Car did a nice job in the quarter.

Operator:

Thank you. Your next question comes from Deane Dray from RBC Capital Markets. Your line is now open. Please go ahead.

Deane Dray (Analyst - RBC Capital Markets):

Thank you. Good morning. A couple of questions. I was hoping you could give some clarity on that whole inventory situation with residential HVAC and the new SEER requirements and has that inventory been sorted out? And then secondly, some commentary on the strength you saw in EMEA, that up 22% FX.

Mike Lamach (Chairman & CEO):

Dean, on where we sit with 13 SEER, just for competitive reasons we are not going to talk much about that. We really don't want to discuss our position at this point in time.

The main thing we are trying to do is we saw across the business a lot of order volatility starting last summer, and I commented on that in the third and fourth quarter. And frankly, that volatility was broader than even the min/max requirements we would have for stocking key components.

So rather than trying to guess the volatility of the markets, we have expanded those mid/max's for key material, for components and assemblies, particularly in high margin businesses, where cycle times were very short. And there was some discretionary opportunities with customers that wanted to buy what was on hand.

And so we took that up, and I think that is an important point, because we are looking at installment rates and recycle times to be balanced with inventory levels, and the net of that really is strong growth in the quarter and improved customer delivery rates. I'm not sure where working capital will really end for us exactly, but frankly, if we can continue to get strong growth, great fulfillment, it is an inexpensive investment in terms of the EPS growth for the company.

Europe just continues in the HVAC business, but I would also say across all businesses, to perform very well. A standout was the HVAC business, as it has been for probably more than a year now. And it is th combination -- there's just winning combination of having the right management team on the ground, a lot of new product hitting the markets at the right time, and a combination of that really coming together with some great results. I think they were probably north of 20% before currency in that business.

Mark Douglass (Analyst - Longbow Research):

Thank you.

Operator:

Thank you. And your next question comes from Jeff Sprague from Vertical Research. Your line is now open. Please go ahead.

Jeffrey Sprague (Analyst - Vertical Research Partners):

Thank you. Good morning, everyone. Mike, could you give us a little more color on what is going on in the institutional markets, institutional applied in particular? And it does sound like commercial unitary was robust also. Is there any particular verticals there that are standing out?

Mike Lamach (Chairman & CEO):

It is interesting, Dodge is calling for an 11% increase in institutional. It is about -- still 25% off its peak and we have contended that you are more likely to see an extended mid single digit institutional recovery, perhaps over two or three years.

Education is probably a little better than 5%, health care is looking at probably a little less than 5%. Those are two important markets for us. I commented that we needed to see some education orders moving through the pipeline. We are seeing that. So that is positive.

And we would expect health care, which typically are going to be a bit more complicated, a bit more applied, work going in there, applied engineering, applied product going in there, probably late this year, early next year, so that is shaping up. We are seeing strong still commercial and manufacturing construction going on. That vertical as relates to HVAC, I'm talking about industrial buildings being built, and the commercial buildings being built, continues to be strong.

But we have had great success with light commercial. That is a product growth team for us, they have done an excellent job. Sue commented that we've seen double digit growth year-over-year there, so we are very pleased with what is happening across that business.

Jeffrey Sprague (Analyst - Vertical Research Partners):

And just a quick one for Sue, to follow up. You had FX gains, in other. Can you just describe where are you at on hedging for the year and what the strategy is and how hedged you might be?

Sue Carter (SVP & CFO):

Right, so Jeff, when we think about what goes into the other income and expense, and the favorability that you see in Q1, that whole line is going to be a couple of different items, one of which is the foreign exchange that I will get to. What is also in there is earnings from some of our equity affiliates, some interest income, and as you might expect, the other cats and dogs on the P&L that don't fit into another line item.

In general, that line item is going to be somewhere between $2 million and $6 million favorable, and if you think about looking back to the fourth quarter, it was actually $6 million favorable. So you've got the $10 million in the first quarter. Not unheard of.

But the big drivers for the first quarter, to answer your question, were better earnings out of our equity affiliates, and then also the foreign exchange gains an losses outside of the Venezuelan currency devaluation. Now, what happens with the foreign exchange gains and losses is the only thing that we do cash flow hedging on is our balance sheet position, and things that are known to us, so when we put those hedges on, if the dollar is strengthening, when you close out those positions, you get a gain, and that is part of what we saw in the first quarter.

It doesn't mean that that is repeatable, because as you roll those hedges, you are resetting the rate, and if you look at Q1, this is the biggest change quarter over quarter, in terms of foreign exchange rates, particularly on the Euro that would have been an average of $1.33 last year, and $1.09 this year. So again, some nice gains that are in there from a transactional point of view.

And we try -- there isn't a direct percentage that I would say is hedged, but we are looking at things with the inter-company loans and things that are known that don't have a lot of volatility and risk for those. And that is just a routine for us that we are putting cash flow hedges out for that.

Operator:

Thank you. And your next question comes from Robert McCarthy from Stifel. Your line is now open. Please go ahead.

Robert McCarthy (Analyst - Stifel Nicolaus):

Hi, good morning, everyone, how are you?

Mike Lamach (Chairman & CEO):

Good morning.

Robert McCarthy (Analyst - Stifel Nicolaus):

I just want to talk about the trajectory for US nonresidential construction in terms of how you are seeing it, in terms of the exit rate, in terms of orders, coming into March and April. How are you feeling about the year, and then maybe we can talk about operating margins throughout the back half.

Mike Lamach (Chairman & CEO):

I think that a mid single digit view is a good view. Again, I think that you will see education maybe a bit north of 5%, health care a bit less than 5%. We will still have a good you unitary business for office and manufacturing. So really sticking to that mid single digit. And to your earlier point if things continue to shape up, maybe it is to that high end of that range and we will come back and adjust in July.

Robert McCarthy (Analyst - Stifel Nicolaus):

And just given the cadence of the year and all of the noise you are seeing and obviously some of the incremental headwinds with FX. How should we think about the cadence for incremental margins and climate throughout the back half of the year?

Mike Lamach (Chairman & CEO):

Well, in general, for the company, I would start -- you would look all-in reported about 25, and if you take out acquisitions, you probably are closer to 30 to gross margins. The company climate would do about the same.

Interestingly, when you see translation in our company, obviously it is going to impact businesses, like industrial that has a higher exposure to foreign currencies, which is a higher margin business than our climate business. You also find in there that TK is one of the most global businesses we have so obviously the operating leverage to deleverage on currency there is higher coming back in.

So it is much -- obviously, more difficult to offset translation per se, so we have to drive harder with productivity to be able to do that. And that's the road map that we are building. And so where a lot of companies I know have taken down guidance as a result of currency, I felt; a, it was too early in the year for us to do that; and b, we have had good success with productivity, some good volume in the quarter and feel like the leverage should support staying with the range that we've got at this point.

Sue Carter (SVP & CFO):

And the other part of that, Robert, is going to be that the direct material inflation. We talked about, we've got some inflation in the first quarter, and a bit in the second quarter, some of that tier two carryover, in the back half of the year. We see that levels out, and we are not getting material inflation, so that also helps the leverage in the back half of the year for actually both of the segments.

Operator:

Thank you. And your next question comes from Julian Mitchell from credit Suisse. Your line is now open. Please go ahead.

Julian Mitchell (Analyst - Credit Suisse):

Hi, thank you. Just a question on the industrial margins. You've got the target for the year 14.5% to 15.5%. I just wondered if you think you will be able to get that into in Q2 where it's really about a big second half move?

Sue Carter (SVP & CFO):

I think that as we look at it, Julian, our projections would say that we are going to continue to grow into the second quarter, we will be stronger than the first. So I don't want to not allow for any breakage but I think we will start to see things get close to that range in the second quarter for industrial.

And when we think about what is happening there, they are still going to have the big FX impacts. They are still going to have the Cameron step-up. But there is productivity and the additional volume that is going to help them. So the short answer to your question is, yes, we should get close to that in the second quarter.

Julian Mitchell (Analyst - Credit Suisse):

Thanks. And then my second question, your Asia revenues organically, were down sort of four consecutive quarters now. Just maybe give us a bit of an update on that. I understand there has been a price war in Chinese HVAC for six months or more. And do you think that your Asia business can get back to organic growth in the next six months?

Mike Lamach (Chairman & CEO):

The overall market is down, so it is not actually any sort of a shear issue. And somewhat choppy. And we have seen this before in China in terms of the choppiness and the shortness of the cycles that we've had years of two quarters down, two quarters up, not up. And I think you are looking at that here.

The pipeline there would support a back half of the year, which is stronger than the front half of the year. And so even for the second quarter, we are likely to see sort of flat for the overall, and company, down in terms of bookings. But for climate I would expect to see an uptick in Q2, potentially high single digits, maybe even better in bookings -- timing, bookings comes in as we expect. And then for the full year we should have pretty strong growth there in HVAC.

Operator:

Thank you. And your next question comes from David Raso from Evercore. Your line is now open. Please go ahead.

David Raso (Analyst - Evercore ISI):

Good morning. My question is on Thermo King. The strength's obviously been North America for a while but seeing some improvement in Europe. Can you flush that out for us? What are the order growth rates are you seeing in Europe? Just trying to maybe find a little offset to Thermo King is down in 2015 domestically, do we have some international offsets?

Mike Lamach (Chairman & CEO):

Yes, I don't think we've seen the order growth rates really coming back in Europe, although I think there is more optimism in general in Europe. And if you take currency out, obviously just a look at the market for itself, there is more optimism around Europe but we didn't really see that in the first quarter.

The growth we had in TK there was largely North American truck and trailer, but across the world, we would have seen great container growth again. We saw APUs with really strong growth. Something near 50% in that regard. Also, air, rail and bus combined were, up as well, Dave's, it's up. Those businesses are becoming more significant as a total part of the mix at TK.

North America is performing about where we thought it would be. Europe hasn't quite recovered but we think we will a bit toward the end of the year on a constant currency basis. And we expect the ancillary products around rail, bus, and APUs and containers to continue to have good runs. Overall, kind of a mid single digit view.

David Raso (Analyst - Evercore ISI):

And for this year, at least, Thermo King domestically has a pretty healthy backlog. How far does it extend into? Does it cover now pretty much the majority of the rest of 2015?

Mike Lamach (Chairman & CEO):

We've got a pretty good view at 2015. We are slightly less than in [AXE] -- AXE is looking at 43,000 units I think in the last forecast. And we would be something a bit less than that at this point in time. So where AXE is calling for 10%, we are calling for more of a muted mid single digit growth rate there.

Again, if there was some optimism, if we close to view that, hopefully AXE is right, again this is where we've got inventory in place, in case it is right. That typically can be some longer lead items on diesel engines and that's one of the positions we took, would be a stronger backlog of components and inventory there.

Operator:

Thank you. And your next question comes from Joe Ritchie from Goldman Sachs . Your line is now open. Please go ahead.

Joe Ritchie (Analyst - Goldman Sachs):

Thank you, good morning, everyone. My first question is on Cam. Now you've had Cam in the fold for a quarter. Just wanted to see if you can give us an update on your outlook for that business and specifically whether you have seen any pricing pressure particularly on the oil and gas side of that business?

Sue Carter (SVP & CFO):

Joe, let me try to walk you through the business and the different markets that they are participating in. As we told you, they met our revenue and operating income expectations for the first quarter and were on track with generating the synergies and doing the things that we are planning to integrate the business, so everything is going along as we would expect with the business at this point in time.

If I divide and go into the individual markets for them, processed gas, again, a piece that does have some exposure on the oil and gas side, we are actually seeing some strength in the business, with natural gas, and with LNG. There is some project delays that are happening in perhaps the Middle East, but Petrochem is holding up, as well as Power Generation in some of the pieces, so all in all, processed gas is holding up well.

Plant Air, we are seeing good activity there, with business and the book and turn activity was good in the first quarter. Engineered Air, which is the piece that is exposed to air separation and some of those markets is showing a little bit of a pull-back and that is really more of an across-the-industry type of pull-back. Particularly in Asia, where there was a lot of building and a lot of over capacity in air separation. And on the after-market side, the after-market is stable for us but we of course have plans to grow that as we talked about when we did the acquisition.

So all in all, we are seeing what we expected to see out of the businesses. The markets haven't really let us down in any big way. And again, our exposure is being more on the gas side than the oil side of this, are keeping us on track with what the plan was for the business.

Joe Ritchie (Analyst - Goldman Sachs):

Thanks, Sue. That's really helpful. One follow-up just on the incremental margins just being slightly lower this quarter for a variety of different reasons, lots of moving parts.

It seems, given that you've got an expectation that you are going to get a little bit more price cost leverage as the year progresses, is it fair to say that as we get into the second half of the year, could you see incremental margins that are closer to the type of incrementals that you experienced last year?

Mike Lamach (Chairman & CEO):

If you go back to the first quarter guidance, we probably did just maybe a point or two better in terms of operating leverage than we had guided, so we were pretty close on that. Got there a little bit differently than what we expected, a little bit weaker price, material inflation, a little stronger productivity, a little better volume, a little worse mix> But the bottom line is it was a solid execution to get to the leverage that we had planned.

When you look at getting that [25%] reported up leverage of 30% ex-acquisition [up] leverage, if it imply a better back half than front half. And we are, at this point all of the productivity pipeline, all of the plans we have for price realization are in place, so it is a matter of executing on that. But again, our forecast will be [25%] or 40% to 30% ex-acquisitions on leverage for the full year.

Operator:

Thank you. And your next question comes from Shannon O'Callahan from UBS. Your line is now open. Please go ahead.

Shannon OCallaghan (Analyst - UBS):

Good morning.

Mike Lamach (Chairman & CEO):

Good morning, Shannon.

Shannon OCallaghan (Analyst - UBS):

Just a question on the acceleration in the Americas HVAC bookings up to the high single digits. I think it has been a while since we have been there.

Does that feel like achieving lift-off to you guys? Or is there something that keeps you in check, whether it is because it is 1Q or something else you are seeing out there that doesn't want to extrapolate that?

Mike Lamach (Chairman & CEO):

I think we are getting great lift-off on the product growth teams we put in place. And again, I couldn't be more happy with the efforts that that entire team, which is a very broad team of product management engineers, operational people and the whole selling organization, doing a fantastic job with that. So I am more pleased with the execution of product growth team than I would be to call on [one of the] more than what I have, which is a decent institutional market which believe me, we are delighted to see after years of negative.

It will be a positive. And I think that the commercial and industrial building and retrofit marks have some legs left as well, too. But again, we're -- all in all, even Dodge would say we are 25% off the peak. So we have got a long way to go.

Shannon OCallaghan (Analyst - UBS):

And then just on the M&A versus buyback with the discretionary cash, maybe just a little more color on what you are seeing out there in terms of the M&A environment and what kind of things are you looking at? Which segments or size we might view as possible?

Mike Lamach (Chairman & CEO):

We have taken the philosophy across all of our businesses to look for the best opportunities, and so I think the filtering that we would do, and the balancing that we would do would be at the corporate level. But as it stands right now, we have really got all of our businesses looking for the right tuck-in opportunities that are markets we know well, either channels that we can use to exploit new products and services, or the other way around, we've got products that we need to channel for it.

So those are the typical acquisitions we are looking for. Obviously, we are trying to balance toward a 15% overall operating margin target for the company so that pushes us to looking for good businesses, where the synergies are clear, and that is a tough threshold obviously to look at out there for us.

But look, it is competitive out there in terms of acquisitions still today. A lot of these pipelines take a long time to develop. A lot of these are based on historical relationships or relationships we are building with companies that we would have an interest in.

In some cases, they may be partners or suppliers to us in other areas. So, it is across the board, Shannon, and I wouldn't highlight or isolate one particular interesting business for you.

Operator:

Thank you. And your next question comes from Steven Winoker from Bernstein. Your line is now open. Please go ahead.

Steve Winoker (Analyst - Sanford C. Bernstein & Company Inc.):

Thanks. Mike, Sue, Joe, thanks for getting to me. A couple of questions I would like you to put a finer point on. The first one is on your material inflation assumptions for the rest of the year.

Copper, steel, particularly, seems to me like there is a lot more opportunity than what I am hearing in your commentary. Can you just help me understand how you are thinking about your raws?

Mike Lamach (Chairman & CEO):

The copper and steel are moving in the right direction, Steve. We buy a lot more component in assemblies. That is two-fold. One is in some cases are you paying more for overall general wage inflation where freight inflation, in some of those commodities, it's not always just the material commodity decrease as a part of the assembly.

But we are working with suppliers to make sure we are getting our fair share of that back, and where that is not happening, we will clearly resource that through a supplier, with the better price point, and that will take some time as well. So I think we are on top of it.

We do see a flattish-to-down overall inflationary environment. And certainly steel and copper and zinc are factors that are positive in that, as well as freight for that matter.

Steve Winoker (Analyst - Sanford C. Bernstein & Company Inc.):

Okay. I think you would be in a pretty good negotiating position right now on those. On the other question, the finer point on volume mix. So 8% core gross and volume mix, 100 basis points of expansion, mix must have been really bad. Or just help me understand the tradeoff between those a little bit given the very, very strong core growth you had.

Mike Lamach (Chairman & CEO):

Well, climate grew specifically in HVAC much -- it was the largest contributor to the overall absolute in the company. It was largely equipment. It has a long service tail on that and that takes a while to materialize over time. So, look, when you are mixing higher climate versus industrial, and higher HVAC versus TK, it puts a bit of a challenge into the mix. But that is really the sum of it.

Operator:

Thank you. And your next question comes from Steve Tusa from J.P. Morgan. You line is now open. Please go ahead.

Steve Tusa (Analyst - JPMorgan):

Good morning. I think you guys are -- the majority of your inventories are -- what are they, 50% is LIFO? Is that right?

Sue Carter (SVP & CFO):

It is something like that, yes.

Mike Lamach (Chairman & CEO):

We can let you know.

Steve Tusa (Analyst - JPMorgan):

Is there a dynamic there on how the raw materials benefits are going to run through, given the more pronounced seasonality in your business? That's the first question. And what kind of impact that may have.

And then just on the buyback. Just remind us where you guys stand on your authorization for the buyback. And do you need a new one to -- if you are going to do more in the back half, do you need a new one?

Sue Carter (SVP & CFO):

So let me take the share buy back, because that is probably easier to LIFO, but I will come back to LIFO. We had the $1.5 billion authorization in 2014 and as of the end of the year we had utilized about half of that.

So given the minimum of $250 million that we had said for 2015, that still will carry us through the year. So no problems on the share buyback authorization.

On the LIFO side, with prices going down and volumes, there was no impact as I looked at the financials, really in the first quarter, from LIFO and I wouldn't expect that to change as we go through the latter part of the year, Steve.

Steve Tusa (Analyst - JPMorgan):

Okay. Great. And then one last question, just on the non-resi stuff. JCI also out there saying things are pretty positive.

On the institutional front, I believe the Dodge forecasts have got an lot better. Maybe if you could just -- just with the sales guidance, it just seems like things are getting better, not worse out there. How much visibility do you have into the back half of the year now for commercial HVAC?

Mike Lamach (Chairman & CEO):

Look, we had great performance in the quarter, revenue had a great performance in terms of orders; applied, the books are filling up through the fall. Education, a little less applied; health care, a little bit more applied. So you would see it is a little more of a move-up there.

Unitary continued strong, Steve. That, I don't think, is going to slow down much for the year. So yes, we are optimistic in a low mid single digit growth rate. Dodge has been optimistic for a long time. And so we have generally used our own pipeline and a triangulation of all of the data that we have and have had a fairly accurate estimate over the last, four or five years around that.

I don't see any reason to change from that. With that being said, look, if there was some sort of a boom we are missing here, once again, it is this sort of component inventory, particularly on the applied side, that we are going to make sure that we are not cutting ourselves too thin in terms of inventory. Now, we have plenty of capacity. That's not an issue for us at all on the capacity for applied.

Joe Fimbianti (Director of IR):

Operator we will take two more, please.

Operator:

Thank you. And your next question comes from Robert Barry from Susquehanna. Your line is now open. Please go ahead.

Robert Barry (Analyst - Susquehanna Financial Group / SIG):

Hey, guys, good morning, thanks for taking the question. I wanted to start by just clarifying what the message was on the commodities. I don't want to mince words too much, but I think on the 4Q call, you had talked about commodities still being a modest net headwind for this year. And Mike, you just mentioned it being flat to down. So, I just wanted to clarify what the bottom line message is there.

Mike Lamach (Chairman & CEO):

It is so close to flat that I couldn't call it either way, frankly. But it is certainly not going to be, to my mind, much of a head wind, if any head wind at this point in time, if things continue as they are continuing. It would be a slight tailwind for us.

Robert Barry (Analyst - Susquehanna Financial Group / SIG):

Okay. So, that sounds a little better than what the message was last quarter.

Mike Lamach (Chairman & CEO):

That is also part of why pricing probably isn't as strong, too. Again, it is all about this gap between price and some of the commodities which drives some of the pricing in the marketplace.

Robert Barry (Analyst - Susquehanna Financial Group / SIG):

Fair enough. And then also just warranted to follow up on the answer to a prior questions about TK in Europe and clarify the outlook. I think you had guided to low single digit decline in Europe.

In the first quarter you are seeing high single digit growth. I don't know if one of them is with currency and one is without. But, maybe you can clarify that and if you are seeing high single now and expect low single for the year, does that imply a meaningful deceleration through the year? Any color there would be helpful.

Mike Lamach (Chairman & CEO):

European revenues were actually up high single digits organically. And if you take FX against that, obviously you get a story. Which isn't as rosey.

Sue Carter (SVP & CFO):

Yes, the low single digits was with currency.

Operator:

Thank you. And our last question comes from Jeff Hammond from Key Bank. Your line is now open. Please go ahead.

Jeff Hammond (Analyst - KeyBanc):

Hey, good morning, guys. Mike you mentioned being more confident in your product groups and the way you are going to market in commercial versus say, optimism about on the demand side. Can you just give us a little more color on what they are doing right, what you are excited about from a new product, or how they go to market differently that is driving that?

Mike Lamach (Chairman & CEO):

The market and analytics and the segmentation we are doing around some of the customer segments has been really critical. Both in understanding about what will grow and why, what competitors are doing, or likely to do, scenario planning around that, economic value estimation of the products we are launching and making sure we are valuing the product versus looking at it on a cost-plus basis.

All of that really consummating and having an operations team, an engineering team and a product management team having the same goals and objectives. This is an example, if a plant manager is looking to maximize inventory turns and a product manager is looking to maximize product availability, they are obviously in conflict. When these people all agree on what it is, as to being the number one or number two thing to grow market share and margins, great things happen.

We've got those teams totally aligned on how to grow margin and how to grow market share, and if you talk to anybody on that team, no matter what stripe they wear from ops, engineering, sales or product management, they are going to give you the same exact answer. And that's where the investments are going. And they are not going anywhere else.

And again, this is why we've got 3, 4 times growth in the overall portfolio last year, this is why I'm excited about doubling that this year and ultimately this is why I'm excited about the, say the next five years, because we will build this thing out all the way. People have a great time doing this. They feel like they're winning and we are going to keep going as fast as we can.

Jeff Hammond (Analyst - KeyBanc):

Great. Thanks a lot.

Operator:

Thank you. I would now like to turn the conference back to Joe Fimbianti for any further remarks.

Joe Fimbianti (Director of IR):

Thank you all very much for this morning. Hope to see you at our investor day in May. I will be around for the rest of the day so please call me if you have any additional questions.

Operator:

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program.