

Why We Own Johnson Controls International

At Children's of Alabama, a hospital that cannot afford downtime, upgraded chillers and heat pumps reduced heating-fuel use by 69% and cut annual energy costs by \$700,000. Johnson Controls reports that adding its AI-enabled OpenBlue optimisation platform increased the annual saving to nearly \$900,000.

Those figures are company-reported rather than independently verified. But they make the proposition tangible: use less energy, reduce emissions, protect critical operations and release money for patient care.

Johnson Controls earns revenue by helping customers make essential buildings work more efficiently. The outcome and the investment opportunity arise from the same activity.

A similar constraint is urgent in data centres. Every server converts electricity into heat. As computing density rises, removing that heat becomes part of the economics of artificial intelligence and cloud services. A data centre can run out of cooling before it runs out of computing demand.

Johnson Controls' equipment, controls and services sit behind walls and on rooftops, where few building users see them. When those systems work better, a customer can use less power, protect uptime and sometimes unlock capacity that would otherwise require new infrastructure.

Structural demand meets a physical constraint

Buildings account for a large share of global energy use and emissions, but the investment case is broader than decarbonisation. Owners face rising power costs, ageing equipment, tighter standards and a need for resilience. Data centres add another constraint: more computing requires more electrical and thermal capacity, often where grids are already stretched.

That creates durable spending on efficient cooling, heat pumps, controls, fire protection and maintenance. The opportunity includes existing buildings: retrofitting a hospital or office tower can produce measurable savings without waiting for a new asset.

Johnson Controls is positioned across that cycle. Following the sale of its residential and light-commercial HVAC business to Bosch in 2025, it is more focused on commercial and mission-critical buildings. It supplies large heating and cooling equipment, building-automation systems, fire and security products, digital optimisation software and the technicians who install and service them.

The customer is buying more than a chiller: it is buying dependable operating conditions.

The 2026 Sustainability Report says 77% of new-product research and development in 2025 was directed towards sustainability and climate-related innovation, including efficient

equipment, lower-impact refrigerants, heat pumps and digital integration. This is company-reported evidence of intentional capital allocation behind the same opportunity that drives customer demand.

How the company makes money

Johnson Controls earns revenue from products and systems, installation and a substantial service activity. That mix matters. Equipment creates an installed base; controls connect assets and make their performance visible; maintenance, upgrades and replacement work extend the customer relationship.

The combination can create switching costs. A hospital or data centre cannot casually replace systems managing temperature, airflow and safety. Johnson Controls also brings recognised brands, engineering knowledge and a global field organisation. These advantages are not absolute - Trane Technologies, Carrier, Siemens and others are capable competitors - but the breadth of equipment, controls and service matters at complex sites.

Where it fits. Johnson Controls sits primarily within Delta's Climate Action theme because its equipment and controls help customers electrify heating, improve building efficiency and use energy more productively. Delta's other themes are Nature Innovation and Human Advancement. They overlap here - efficient cooling can reduce water and resource pressure, while safe hospitals and healthy buildings serve people - but we use one primary classification to keep the portfolio understandable.

From cooling demand to earnings

The latest results show the commercial mechanism more clearly than any thematic label.

For the quarter ended 30 June 2026, Johnson Controls reported sales of \$6.6 billion, up 9% (10% organically). Organic orders increased 27% and backlog reached a record \$21.0 billion, 32% higher than a year earlier. In the Americas, orders rose 37% and backlog 40%, supported by data centres and other mission-critical environments.

Demand alone does not guarantee attractive economics. The question is whether activity becomes profit and cash. In the quarter, the Americas' adjusted segment margin increased by 260 basis points to 21.1%, and the group's adjusted operating margin rose 260 basis points to 16.9% - genuine margin expansion from volume and productivity, not simply higher volume passing through. Cash from operations was \$1.29 billion for the quarter, and adjusted free cash flow was up 63% year-to-date to \$2.1 billion.

Management raised its full-year expectation to about 8% organic sales growth and approximately \$5.05 of adjusted earnings per share, both above analyst consensus. Those forecasts are not promises. They do, however, show how the chain is intended to work: mission-critical investment drives orders; orders become backlog; backlog converts to revenue; higher volume, mix and productivity expand margins; and cash generation supports reinvestment and shareholder returns.

The attached service opportunity may lengthen that chain further. Management now expects data centres to reach roughly one-third of company sales within three to five years, up from a high-teens share this year, and equipment sold today will need inspection, maintenance,

software and eventual replacement for years afterwards - the kind of recurring revenue that makes for a higher-quality business over time, if Johnson Controls can convert the opportunity into service contracts rather than one-off equipment sales.

A financially strong business, mid-transformation

A compelling theme only matters if the company behind it can convert demand into durable profit and cash, year after year, not just in a single strong quarter. Johnson Controls' recent record on this front is genuinely mixed, and we say so plainly rather than smoothing over the parts that don't yet work.

Profitability. Over fiscal 2023 to 2025, Johnson Controls' operating margin moved from 10.8% to 10.3% to 12.0% - modest, uneven improvement rather than a clean upward trend. The more demanding test of quality, return on invested capital - essentially, how much profit the company generates for every dollar it has put into the business, whether raised from shareholders or lenders - tells a similar story: 7.0% in fiscal 2023, up to 9.4% in fiscal 2024, then back down to 7.6% in fiscal 2025, averaging below the roughly 9% cost of capital we look for a business to clear consistently before calling its capital efficiency genuinely good.

Earnings growth. Reported earnings per share are flattered by a one-off item: fiscal 2025's headline figure of \$5.48, against \$2.80 the year before, was inflated by a large gain on the sale of the residential HVAC business, so the fairer comparison is adjusted earnings per share, which grew a modest 4.5% in fiscal 2024 and 18.9% in fiscal 2025 - real progress, but not yet the sustained double-digit compounding that would make the case on its own. What has changed is the trajectory: the June-quarter result showed adjusted earnings per share of \$1.42, up 35% year-on-year and comfortably ahead of the roughly \$1.30 analysts expected, and management responded by raising full-year guidance to around \$5.05 a share, implying about 34% growth for the year as a whole and sitting above consensus.

Shareholder returns - a volatile record, recently strong. Johnson Controls' shares have not delivered a smooth ride. Over the five calendar years to the end of 2025, total shareholder return - share price growth plus dividends - was strongly positive in three years (77% in 2021, 40% in 2024 and 54% in 2025) but negative in the other two (-20% in 2022 and -8% in 2023), compounding to roughly 23% a year across the period as a whole, with a further 18% gain through the first half of 2026. That average conceals real cyclicality: an investor buying at the wrong point in 2022 or 2023 would have waited some time to be made whole.

What is credible about the current story is that it is no longer just guidance. One widely used third-party valuation model raised its fair value estimate for the shares sharply, from \$111 to \$129, after the June-quarter beat, and now projects return on invested capital climbing to 12.1% in fiscal 2026, 16.6% in fiscal 2027 and above 20% by the end of the decade, driven by the same mix shift toward higher-margin commercial HVAC, controls and service work that produced this quarter's margin expansion. Even so, that model puts the shares themselves modestly above its own fair value estimate at current prices - a stock priced for the improvement to continue, not one still offering a margin of safety.

Taken together, this gives us a credible, evidenced path to the returns this thesis needs - built on an actual quarter of margin expansion, order growth and a guidance raise, not projections alone - but one that is not yet proven across a full cycle, and a price that leaves little room for the trajectory to disappoint.

Leadership we can trust

A good business also needs to be well led, especially one only a year into a new chief executive and a reshaped portfolio. On the structural fundamentals we look for, Johnson Controls' governance is strong. The roles of Chief Executive and Chair are held by separate people - a deliberate change the board made in 2025 when it appointed a new Chief Executive and installed an existing independent director as Chair, rather than continuing the previous combined structure. Every director stands for re-election each year, and the board runs a structured self-evaluation annually, with the resulting actions - including changes to succession planning and committee rotation - disclosed publicly rather than kept behind closed doors. There is a single class of share, so no shareholder carries outsized voting power over the rest, and the Audit Committee is staffed entirely by independent directors and chaired by one with 37 years of finance experience, including a prior chief financial officer role. Nine of the eleven board members standing for election are independent under Delta Outcomes' stricter, tenure-based standard, which reclassifies a single long-serving director whom the company itself still counts as independent under stock-exchange rules. Executive pay is heavily weighted to variable, multi-year performance: the substantial majority of target compensation for the Chief Executive and other senior executives is at risk and tied mostly to multi-year share awards rather than paid regardless of results.

The one governance area where we are not yet satisfied is capital allocation. As the financial-quality section above sets out, return on invested capital has not consistently cleared the cost of capital over the past three years - even though fiscal 2025 also saw roughly \$7 billion returned to shareholders through buybacks and dividends, funded substantially by proceeds from the residential HVAC sale. We read that as evidence of a management team willing to simplify the business and return surplus cash rather than empire-build, but it does not yet offset a capital-efficiency record that still has to prove itself organically, not through one-off portfolio moves. Taken together - strong board structure and pay alignment, alongside an honestly disclosed capital-allocation gap the company is actively working to close - this gives us reasonable confidence that Johnson Controls is led by people who will act in shareholders' and stakeholders' long-term interests, though on capital discipline specifically, the record is still being written.

Outcomes as evidence

Impact is useful here because it tests whether the product solves a costly problem at scale. In its 2026 Sustainability Report, Johnson Controls says technologies deployed across thousands of projects have helped customers save more than \$9.5 billion in cumulative energy and operating costs, alongside avoided emissions equivalent to the annual emissions of nearly six million US homes. These are company-reported, aggregated estimates, and the reporting period, attribution method and degree of external assurance are not independently confirmed.

Johnson Controls reports that a UK data centre operated by a global financial-services company improved chilled-plant efficiency by 8% after applying its optimisation software and YORK chillers. The company says power usage effectiveness improved to 1.296; annual energy use fell by 355,000 kWh and annual energy costs declined by £38,084 while operational stability was maintained.

These are company-reported results from an unnamed customer, not independently verified figures, and should be treated as evidence with limits rather than a universal performance claim. Even so, the causal link is valuable: better control reduced electricity use and cost in a mission-critical facility. The outcome supports the commercial proposition rather than replacing it.

The report also provides evidence about how Johnson Controls operates its own business. It says absolute Scope 1 and 2 emissions have fallen 46% since 2017, Scope 3 emissions from use of sold products have declined 33%, and 91% of global electricity needs are met or matched with carbon-free energy. These operational and product-use figures do not make the shares attractive by themselves. They do show a company deliberately improving how it operates while building products for a sustainability-linked growth market.

Value, decision, and tension

We own Johnson Controls because three things are converging, even though not all three are finished stories yet: a durable, structural source of demand from data centres, hospitals and other mission-critical buildings; a business whose profitability and capital efficiency are inflecting sharply upward from a genuinely uneven three-year base, evidenced now by an actual quarter of margin expansion, record orders and a guidance raise rather than promises alone; and a board and leadership team we trust on structure, accountability and pay, still proving itself specifically on capital discipline.

We do not own it on the assumption that every data-centre build-out proceeds as planned, that the current pace of margin and order growth continues uninterrupted, or that a single strong quarter closes a capital-allocation gap that three years of numbers have shown. The central tension is that much of the improvement we describe is already reflected in the price: the same third-party valuation model that raised its fair value estimate to \$129 after the June-quarter beat puts the shares themselves modestly above that estimate at current levels. That means the shares now need the forward trajectory to actually arrive, not merely remain plausible, to justify today's price. Valuation discipline, not enthusiasm for the data-centre theme or a single beat-and-raise quarter, is what governs position sizing here.

What could break the chain

A number of things could weaken this thesis, and we watch for all of them:

- Demand and execution risk. A \$21 billion backlog provides visibility, but hyperscaler data-centre capital spending could slow, or projects could be delayed or cancelled if customers face their own power, financing or permitting constraints. If orders cool while capacity and costs have already expanded, today's operating leverage could reverse.
- Technology and competitive risk. Data-centre cooling is changing as computing density rises across air, chilled-water and liquid-cooling architectures; a shift that reduces the value captured by Johnson Controls' equipment or service model would weaken the thesis. Separately, the Fire & Security business's US service backlog has already softened under competitive volume pressure in a flat underlying security market.
- Financial-quality durability risk. The margin and capital-return improvement described above rests on one strong quarter and a set of analyst forecasts, not yet a multi-year

record. Return on invested capital would need to sustain its projected climb through at least one weaker cycle before we would call Johnson Controls' capital efficiency durably good rather than newly recovering.

- Geopolitical and valuation risk. EMEA growth is being held back by the conflict in the Middle East, and at a share price already assessed as modestly above fair value by a widely used third-party model, a guidance miss or margin disappointment could produce a disproportionate market reaction - as the roughly 2% share-price fall on results day, despite a clear beat-and-raise, already illustrates.
- Impact-case risk. The efficiency savings Johnson Controls reports - including the \$9.5 billion of cumulative customer savings and the individual case studies cited above - are company-reported and not independently verified, and equipment-level efficiency gains can be outweighed by growth in total electricity and cooling demand across the buildings and data centres the company serves.

The thesis would weaken materially if order growth failed to convert into backlog and revenue, if return on invested capital failed to sustain its projected climb once the current cycle turns, or if verified customer outcomes and service quality fell short of the company's own claims. It would also weaken if the current valuation left no margin of safety for any of these risks to materialise together.

Johnson Controls is compelling because its equipment and controls sit behind an increasingly urgent physical constraint on the digital economy - and because a business that spent much of the past three years proving itself only unevenly is now, on the evidence of an actual quarter's results, converting that demand into the margins, earnings and capital returns a strong industrial business should deliver. We hold the company to the same standard on financial quality and governance as we do on impact: real evidence, honestly weighed, not a theme taken on faith. The investment case rests on Johnson Controls turning a genuinely structural need - keeping essential buildings and data centres running - into durable, well-governed cash flows, at a price that still leaves room for the story to be wrong.

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