FOURTH QUARTER 2025 HIGHLIGHTED HOLDING: DAIKIN INDUSTRIES

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Heavy U.S. investment, a mistimed refrigerant transition, and cyclical weakness have pressured Daikin's margins and returns. As these headwinds fade, we see a clear path to normalized profitability.

Headquartered in Japan, Daikin Industries is the world's largest manufacturer[1] of heating, ventilation, and air-conditioning (HVAC) equipment, serving residential and commercial customers in more than 170 countries. In recent years, capital efficiency has declined as the company invested heavily to build out its U.S. manufacturing and distribution footprint, while execution missteps during the U.S. refrigerant transition resulted in temporary market share losses. These company-specific challenges have coincided with cyclical weakness across key regions. At 9.0x our normal earnings estimate, the shares reflect expectations more consistent with structural impairment than with Daikin's position as a global technology leader capable of long-term profitable growth.

		Earnings Per Share			Price/Earnings		
	Price	FY 26E	FY 27E	Normal*	FY 26E	FY 27E	Normal*
Daikin Industries, Ltd.	¥20,080	¥959	¥1,050	¥2,227	20.9x	19.1x	9.0x

Fiscal year-end March 31.
**Pzena estimate of normal earnings.*
Source: S&P Capital IQ, Pzena analysis
Data as of December 31, 2025.

BUSINESS AND INDUSTRY DYNAMICS

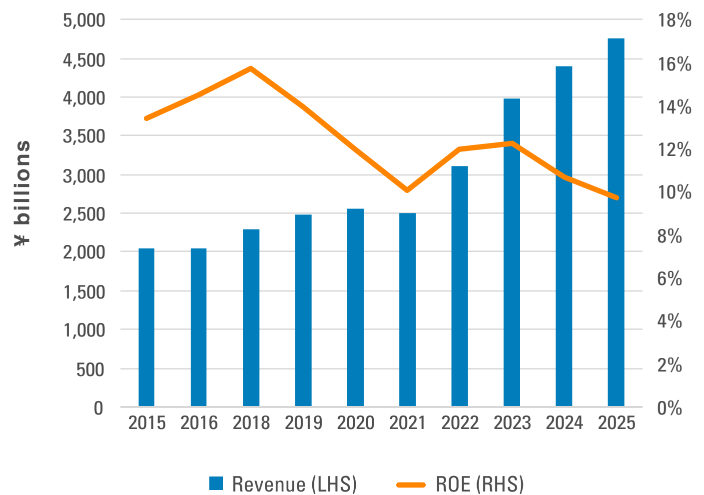
The global HVAC market generates approximately $275 billion in annual revenue and is consolidated at the manufacturing level around a small group of scaled, multi-brand incumbents, including Daikin, Carrier Global, Trane Technologies, and other leading Asian manufacturers. While distribution and installation remain fragmented, HVAC manufacturing faces meaningful barriers to entry due to stringent, region-specific regulations and the need for localized manufacturing to manage cost and lead times.

Within this structure, economics differ meaningfully across end markets. Residential HVAC represents roughly 40% of global demand, with manufacturers earning most of their profit at the point of equipment sale. Installation and service are handled by third-party contractors. Non-residential HVAC accounts for the remaining 60% of demand[2]. This segment includes light commercial systems with similar equipment-sale economics, as well as large-scale commercial, data center, and industrial applications, where manufacturers often retain service relationships and generate the vast majority of profit through aftermarket and service revenue.

U.S. INVESTMENT: NEAR-TERM PAIN, LONG-TERM GAINS

Over the past decade, Daikin's revenue has grown steadily, with only a brief COVID-related interruption. However, since mid-2023, the company's stock has underperformed the broader market, driven in part by a sustained decline in return on equity (see Exhibit 1).

Exhibit 1: Revenue vs. ROE



Source: Company filings

This pattern of revenue growth alongside declining returns reflects Daikin's long-term effort to build a more competitive U.S. platform. The U.S. is the most important profit pool in global HVAC—and Daikin's

1. By sales
2. Source: Grand View Research

largest single market—but the company's U.S. operations historically lacked the degree of vertical integration that management believed was necessary to earn attractive returns. Earlier acquisitions, including McQuay and Goodman, established scale in commercial and residential HVAC, respectively, but did not, on their own, create an optimized operating model, leaving U.S. margins well below peer levels.

Over the past few years, management has invested heavily to close this gap, expanding U.S.-based manufacturing capacity, internalizing key components, and strengthening its distribution, service, and support infrastructure. In residential HVAC, these investments have strengthened the cost position, product availability, and mix, including greater penetration of inverter-based systems, which are more energy-efficient and carry higher margins. In non-residential HVAC, investment has supported expanded service capabilities and aftermarket penetration. With the bulk of this investment now complete, profitability should increasingly benefit from favorable mix and operating leverage.

REFRIGERANT TRANSITION: A TIMING ERROR

Layered on top of the U.S. investment cycle was an execution misstep during a mandated refrigerant transition. Refrigerants are chemicals that enable air conditioning by absorbing and releasing heat, and legacy HVAC systems relied on older refrigerants that regulators have targeted for their higher environmental impact. Under U.S. federal climate policy, manufacturers were required to cease production of systems using these legacy refrigerants beginning in January 2025, with sales and installation prohibited starting in January 2026[3].

Anticipating this shift, Daikin moved earlier than most peers to wind down production of legacy systems and transition toward next-generation alternatives. However, distributors and contractors favored legacy systems due to lower costs and installer familiarity, stockpiling inventory ahead of the production cutoff. As a result, Daikin lacked sufficient legacy inventory during the transition, leading to temporary market share losses as competitors maintained better availability. With the transition now complete, Daikin has moved aggressively on pricing and channel reengagement, reclaiming its U.S. residential market share to pre-disruption levels.

CYCLICAL WEAKNESS MASKS PROGRESS

Daikin's company-specific challenges, which have begun to ease, have coincided with cyclical weakness across key end markets, obscuring underlying progress and weighing on near-term results. In the U.S., higher interest rates have weighed on residential replacement demand, a slowdown amplified by pull-forward ahead of the refrigerant transition. Tariffs and broader cost inflation have further pressured pricing and margins. In Europe, where Daikin is heavily exposed to heat pumps, adoption has cooled after rapid growth, as subsidy programs were adjusted and high electricity prices made heat pumps more expensive to operate than gas systems. In China, the prolonged property downturn continues to pressure both residential and commercial demand.

These pressures are cyclical rather than structural. HVAC replacement demand can be deferred as customers choose to repair existing systems rather than replace them outright, but it cannot be avoided indefinitely, given the aging installed base and the essential nature of climate control. As interest rates, inventories, and policy distortions normalize, replacement activity should recover. In that environment, the benefits of Daikin's U.S. investments and post-transition stabilization should increasingly flow through to reported results.

EMBEDDED OPTIONALITY

While not central to our thesis, Daikin offers meaningful incremental upside across several long-term growth themes. Emerging markets account for roughly a quarter of Daikin's revenue today, with long-term growth supported by rising incomes, urbanization, and increasing cooling demand. India is a clear example of this opportunity: it represents approximately 4% of Daikin's global sales and has

3. Source: U.S. Environmental Protection Agency, Technology Transitions Program under the American Innovation and Manufacturing (AIM) Act.

grown at 17% CAGR over the past decade. Despite this growth, penetration remains low, and Daikin's #1 market share in India provides a strong platform to benefit as adoption continues to expand over time.

A second source of upside lies in advanced cooling solutions for data centers and other high-intensity applications. Growth in artificial intelligence and cloud computing are driving demand for large-scale, engineered cooling systems. While still a small portion of revenue, this is Daikin's fastest-growing end market and carries structurally higher margins, aligning well with the company's strength in integrated, system-level cooling solutions.

Finally, tightening energy-efficiency standards and decarbonization policies globally support longer-term replacement and upgrade cycles. Daikin is particularly well positioned for this shift given its leadership in inverter-based air-conditioning technology, which materially reduces energy consumption and has been a core focus of the company's R&D for decades.

CONCLUSION

Daikin is emerging from a period of heavy investment, regulatory disruption, and cyclical weakness with a stronger platform that supports improving margins and returns. As capital intensity moderates, earnings growth should increasingly convert into higher free cash flow, adding to the company's net cash balance sheet and supporting a step-up in shareholder returns over time. Despite this improving setup, Daikin's valuation continues to imply structurally impaired economics, especially relative to global HVAC peers that trade at meaningfully higher multiples (see Exhibit 2). For the world's largest HVAC manufacturer, with clear scale advantages, technology leadership, and a path to normalized profitability, this disconnect presents an attractive opportunity for long-term investors.

Exhibit 2: Global HVAC Valuation Comps

	EV / TTM Revenue	EV / Forward EBITDA*
Trane Technologies	4.3x	19.3x
Johnson Controls	3.6x	18.5x
Lennox International	3.4x	15.1x
Carrier Global	2.5x	11.9x
Mitsubishi Electric	1.6x	11.8x
Peer Average	3.1x	15.3x
Daikin Industries	1.3x	8.2x

Source: S&P Capital IQ

**Forward EBITDA based on next-twelve-month consensus estimates.*

FURTHER INFORMATION

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Daikin Industries was held in our Global Focused Value, Global Value, International Focused Value, International Value, Japan Focused Value, and other strategies during the fourth quarter of 2025.

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