
Description:

With solid discipline around price, smooth 14 SEER transition, and some emerging technology around compressors and controls, the US HVAC industry is gradually recovering. In residential, it should result in an outsized volume growth due to low unemployment and gas prices, added with high consumer confidence and depressive demand, while continued price and commodity tailwinds boost margin expansion. Commercial is under more steady status, with continuous non-residential construction recovery which still has some room to run.

US Residential momentum continues, replacement rates accelerating.

Replacement rates have steadily raised over the past few years following historically low levels coming out of the recession, and are now accelerating towards the high end of historical ranges as potential replacement demand is released into the system. This will be further boosted by a positive fundamental setup with high consumer confidence and low unemployment and gas prices, which have historically correlated strongly with replacement rates. It is estimated that the US HVAC market would achieve an 11% growth in 2016 and 5% in 2017.

US Commercial HVAC stable.

Based on a 5% growth ongoing non-residential construction recovery and stable 3% growth in replacement, it is estimated that this market would achieve 4% growth in 2016 and 2017 respectively. 2015 was a strong recovery year for non-residential construction while 2016 could most probably witness some slowing. While most HVAC players' revenue have recovered on regulatory change and pricing, commercial HVAC volumes are still 20% below peak, which means there are still some room to run in this market.

Price/cost positive, the key variable is 14 SEER price, but transition was smooth.

Price was solid again in 2015, a trend that will continue with most companies announcing steady price increases that are expected to mostly stick even in a low commodity environment. Mix up has also been a key topic with the 14 SEER transition performance slightly better than expected and industry mix shifting rapidly away from 13 SEER as the 14 SEER premium held steady at about 10%. This market could see a compression up to 8%, which should come out with another solid mix benefits year. For cost, commodities remain sluggish, and major OEMs follow similar hedging strategies.

Ductless market remains the key theme.

Ductless continues to be a key strategic theme in the industry, which could represent 15% of the industry for both residential (about 9%) and commercial (about 6%). While key obstacles such as first cost, lack of installed base, and aesthetics limit the penetration gains in what should remain largely a ducted unitary market, it is starting to show better adoption rates as energy efficiency gains and flexibility in installation outweigh the higher first cost in many instances. Almost all US OEMs have built up JVs/partnerships with foreign suppliers, and while it is expected a well above market average growth rates in ductless.

Intensified Technology competition among suppliers.

With most OEMs boasting new capabilities, inverter technology is another key strategic theme. Inverter compressors appear to be contained solely within the high end systems at now, with key players expressing interests in spreading this technology in more mainstream systems. In particular, Daikin has mentioned about vertically integrating its compressor technology and taking inverters to mass market products, but this has remained slow to develop for now. In the near-term, there should be no dramatic change here.

Competitive stable; potential for another round of consolidation.

Lennox continues to increase share in both residential and commercial, while Trane performing well in commercial and losing some incremental share in residential. York and some of the smaller HVAC players
are also possible to lose share in residential. The 14 SEER transition has not impacted competitive landscape, and industry discipline remains integrated. On the M&A front, there's potential for another round of industry consolidation. The ultimate outcome of JCI/TYC, and their desire to grow or get rid of HVAC, and the appetite for investment from Chinese/Asia players are to be closely focused.

Potential risks, but under control.

Potentially rising rates are the biggest uncertainty and risk factor, somewhat like auto. Housing still remains good below normalized levels, so any downturn here is unlikely to match that of last cycle. For commercial, the biggest risk remains around the non-residential construction cycle, where significant indicators have been mixed in recent months, and a striking deceleration would be a clear headwind.

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