



# 5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

## JOHNSON CONTROL HITACHI

### WHAT WE LIKE

#### 2 RICH, 100 YR OLD CULTURES COME TOGETHER

In 1885, long before anyone talked about carbon footprints or climate change, Warren Johnson launched a company to explore new ways to harness and conserve precious energy resources. Hitachi was founded in 1910 by electrical engineer Namihei Odaira in Ibaraki Prefecture. Hitachi's first product was Japan's first 4-kilowatt (5 hp) induction motor, initially developed for use in copper mining. These two business giants, who have literally seen it all, joined together in 2015. That itself is telling.

#### GLOBAL DEVELOPMENT CENTRE IN INDIA

A \$22.5 million (approx Rs 157 Cr) investment was made to establish the global development centre for Johnson Hitachi in Kadi, Gujarat in India. The state-of-the-art facility is expected to drive the company's world-class innovation capabilities with a strong focus on developing RACs and commercial packaged ACs for India as well as the Southeast Asia, Middle East and European markets.

#### WHAT HAPPENED IN AMARARAJA MAY ALSO REPEAT IN HITACHI UNDER JOHNSON

Johnson Control started its association with Amara Raja more than 2 decades ago and competed well to establish AMARON as a leading brand against Exide (the market leader) in that period before ending their ties. A repeat of the same can be expected given the kind of investments they are making in R&D, product development, marketing and supply chain distribution.

#### DIVERSIFIED PRODUCT PORTFOLIO WITH HIGH MARKET SHARE IN RAC & VRF GROWING FAST

With an 11% market share in the RAC segment, JCHAC is one of the market leaders today mainly under the Hitachi brand name. But FY20 and FY21 have been difficult for them because of Covid-19.

	1998	2008	CAGR	2008	2018	CAGR	2028
Revenues	113	447	14.74%	447	2185	17.20%	?
EBITDA	8.29	55.31	20.90%	55.31	206	14.05%	?
PBT	3.12	46.88	31.12%	46.88	151	12.41%	?
PAT	3.12	42.25	29.77%	42.25	100	9.00%	?

It is also present in Refrigerators & Air Purifiers space along with Commercial Air Conditioning.

In commercial AC, their VRF segment is growing faster than the industry for many years. It grew by 34% in FY20, which was much higher than the market segment growth.

### WHAT WE DON'T LIKE

#### RAW MATERIAL PRICE RISK

Copper and Aluminum are the two most important raw materials for the RAC & Refrigeration space. And given the RM price rise, we can expect margins to take a hit in the short term. However, we at SSS, believe that brands have the pricing power to pass on the raw material impact to the consumers. Hence, the long term may not be a worry.

#### COMPETITION

Both global and domestic brands have aggressively entered the RAC market. Voltas & LG occupy the first 2 spots in terms of market share but there is tough competition between Hitachi, Daikin & Bluestar for the 3rd position. The entry of e-commerce players like Croma, Amazon & Flipkart has intensified the competition in the RAC space.

#### COVID-19 & HVAC MARKET

Covid-19 has changed the way we work. While work from home may increase the demand for residential Air Conditioning by a notch or two, the companies are planning to cut down their office spaces affecting the demand for commercial air conditioning.

A longer than expected wait for demand comeback in the HVAC space can be a dampener for JCHAC.

#### TECHNOLOGICAL DEVELOPMENT

Post COVID-19, the world will demand sustainable, energy-efficient & safe HVAC technologies.

If JCHAC is unable to be updated and deliver as per consumers' demand, it will be tough for them to maintain their current market share. As of date, they look well equipped. However, the risk stays in the future.

#### VALUATIONS

At 96 times TTM earnings and close to 3 times sales, the valuation looks very expensive at the moment. We, at SSS, believe that if you take into account the lost sales in Q1FY21 & Q1FY22 due to lockdown, which is generally their best quarters, the normalized sales would be much higher. And it's a business with high operating leverage. If growth comes back, the earnings have the capacity to surprise on the upside, and hence the valuation may sustain. Some green shoots are already visible in the Q3 results. However, 3-4 quarters of consistent growth will confirm the thesis.

