Trane Technologies (TT). (NYSE: TT)

Recommendation**: Buy**

TT

Price**: $144.20**

MSCI ESG Ranking**: AAA**

Sustainalytics' ESG Risk Ratings: **Low Risk**

Machinery, Equipment & Components

Analyst: Luc Boesch-Powers

Trane Technologies plc is (NYSE: TT) an American industrial company specialized in the heating and cooling space (domiciled in Ireland for tax efficiency).

According to Wikipedia, its four main brands are Ameristar (HVAC equipment), Service First (HVACR parts), Thermo King (Refrigeration units for transport industry and HVAC units for Buses and Trains) and Trane (HVAC equipment, which includes American Standard HVAC products).

Trane has a market capitalization of $29.6bn, on 2019 revenues of $16.6bn and 2019 earnings of $1.41bn (a trailing PE ratio of 21.0, slightly more expensive than the S&P's trailing PE ratio of 20.18). This is significantly richer than competitor Carrier's (CARR) 2021 PE ratio of 18.8, however Trane is expected to have higher earnings growth, and according to Bloomberg, "investments in ESG friendly technology have helped Trane claim a premium valuation."

It can also be extrapolated from this rich valuation that Trane has superior technology and better long-term prospects. In the past five years, the stock has gained 117.4%, compared to 58.2% for the S&P 500. Generally, market outperformance shows that a company is executing well – and theoretically, will continue to do so.

This year, revenues are forecasted to decline 28.4%, and EPS is expected to decline 39.0% – however, in 2021, forecasts expect a 6.5% and 21.9% increase in revenue and EPS, respectively. In 2021, Trane is expected to have revenues of $12.65bn, and net income of $1.13bn – a PE ratio of 27.22 (slightly more expensive than the S&P 500's forward PE ratio of 25.5). The $4.74 in EPS represents a net income margin of 9%; in terms of free cash flow, the company is expected to bring in $4.63 in free cash flow per share. The company has $2.2bn in net long-term debt, which is very manageable when compared to the company's historical earnings power.

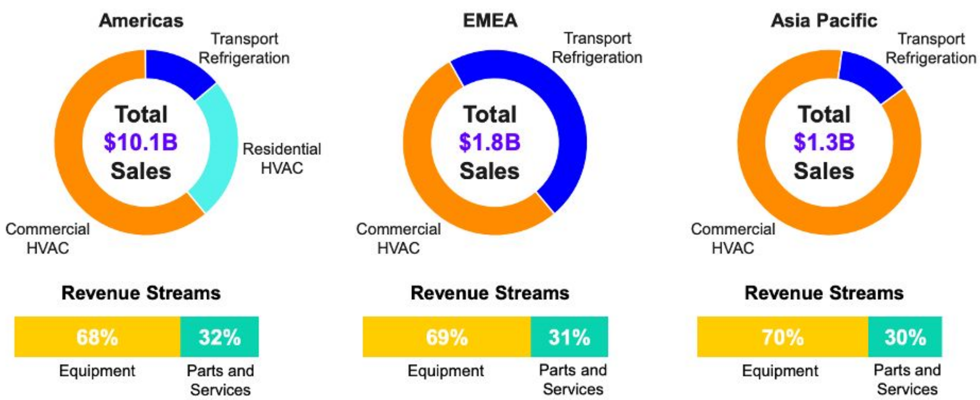

Figure 1: Breakdown of Trane's revenue streams (source: May 2020 Investor Presentation)

ESG-wise, the company receives a stellar AAA rating from MSCI, placing it in the top 10% of all companies in the building products industry. Competitors Carrier, Lennox and Daikin received ratings of A, A and AA, respectively. The company excels in labor management, and is average in corporate governance, carbon emissions, toxic emissions and waste, health and safety, and opportunities in clean tech. Trane is not a laggard in any of MSCI's ESG categories. The company receives 3.9 stars on Glassdoor; 82% of reviewers would recommend the company to a friend and 93% approve of the CEO, Michael Lamach. Finally, Trane was recently lauded by Bloomberg for its ESG prowess, and in 2019, released an 100+ page report that discussed its ESG goals. Most notably, by 2030 the company aims to decrease its customers' CO_2 emissions by one gigaton.

Over the very long term, I believe air conditioning is an industry poised to keep succeeding. Going forward to 2030, according to Brookings, the world's middle class is expected to swell a whopping

47% – an increase of 1.7 billion people. Brookings defines "middle class" as people with "some discretionary income that can be used to buy consumer durables like motorcycles, refrigerators, or washing machines." This is a phenomenal opportunity for Trane not only because the new middle class will be buying HVAC equipment, but also due to the fact that these budding communities –in their new schools, government buildings and businesses– will also require these products as well. At the moment, Trane is only beginning to take advantage of this opportunity – only 31% of the company's revenues come from outside North America.

Second, it is very clear that the world's overall temperature is poised to increase significantly going forward. In the United States alone, according to Vox, by 2050 "the weather (and precipitation) in several Northern cities will look and feel a lot like how Southern cities do today." Moreover, while Vox concedes that these temperature increases might only be about 4-5 degrees Fahrenheit, they also said that weather events such as heatwaves will occur more frequently. Overall, air conditioning will represent an increasingly important role in peoples' lives.

In the near term, a Joe Biden presidency could act as a tailwind to Trane's already rapidly growing business. In an article on Seeking Alpha, Stephen Simpson, CFA writes that one of Joe Biden's plans "calls for an accelerated retrofit program to reduce energy consumption (HVAC-R accounts for about half of U.S. building electricity usage)." He also adds that "even if that plan doesn't happen, tenants are increasingly demanding green buildings to comply with their own ESG goals, leaving building owners with the choice of either upgrading or accepting lower rents."

Going forward, Argus Research forecasts that Trane will grow earnings at a 10% compounded rate in the next five years – slightly higher than the peer average of 9.5%. In recent years, Trane has delivered (for the most part) mid-to-high single digit revenue growth, with earnings growing at about two times those rates during the same period.

Overall, I believe that Trane can continue to deliver solid growth for many years to come, combining organic growth (ESG and technological prowess) with strong secular tailwinds. At a valuation of 21x 2019 earnings, I think this company meets Warren Buffett's definition of a "wonderful company at a fair price." I recommend that investors BUY the stock of Trane Technologies plc for the fundamental reasons alone, and for investors that also consider ESG factors, I believe this company will also be an excellent steward of your capital.