

Powering Artificial Intelligence

AI's rapid adoption is creating a structural growth tailwind for electrical equipment suppliers.

Morningstar Equity Research

October 13, 2025

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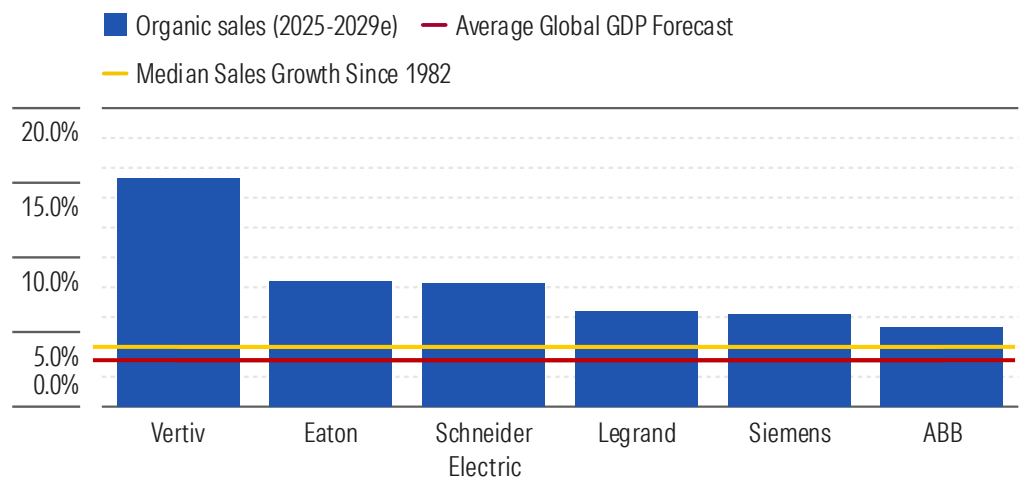
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Executive Summary

Electrical equipment is the backbone of artificial intelligence infrastructure, enabling data centers to handle the immense power needs for AI workloads. Among the capital goods sector, electrical equipment suppliers offer the most direct exposure to data centers, providing investors with an attractive way to gain exposure to the AI theme, beyond the widely discussed hyperscalers or producers of AI chips. While the capital goods sector has historically grown at a rate comparable to GDP, we expect data-center-exposed electrical equipment suppliers to grow between 3 and 5 times their long-term average, benefiting from the surge in investment in AI (Exhibit 1).

Exhibit 1 Data Center Demand Lifts Electrical Growth by Up to 5 Times Their Long-Term Average Growth



Source: Morningstar estimates, IMF. Data as of October 2025.

We forecast that US data center installed power capacity will triple to 80 GW by 2030, fueled by a six-fold increase in the power required to run AI workloads. The build out will drive demand for electrical and power equipment, which contributes between 40% and 45% of the non-IT capital expenditure of a data center. Among capital-goods peers, Schneider Electric and Vertiv are best positioned given their broad data center portfolios and the highest end market exposure.

Key Takeaways

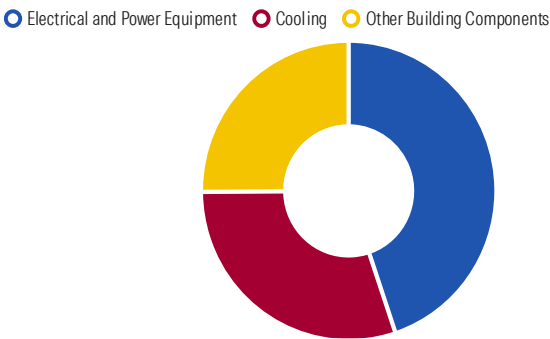
- ▶ Electrical equipment suppliers provide essential equipment needed to support AI infrastructure and enjoy the highest end market exposure to data centers in the capital goods sector, providing investors with direct exposure to the AI theme.
- ▶ We forecast data center demand for electrical products to grow 30% annualized through 2030, driven by a six-fold increase in AI data center capacity. Electrical equipment demand scales with higher installed data center capacity and will see incremental demand for "white space" equipment and cooling.
- ▶ Schneider and Vertiv are our preferred ways for investors to invest in the theme, given their highest exposure to data centers and broad product offerings. While Vertiv has the best growth prospects, its rich expectations are fully priced in by the market. Schneider Electric has a more diversified stream of earnings and trades at a reasonable valuation.
- ▶ The electrical equipment suppliers are somewhat insulated if data center expansion falls short of bullish expectations, as most products can be redeployed across non-data center infrastructure, and supply additions have been disciplined, as evidenced by elevated lead times. Vertiv would be most affected, with its liquid-cooling products almost exclusively tied to data-center demand.

Companies Mentioned

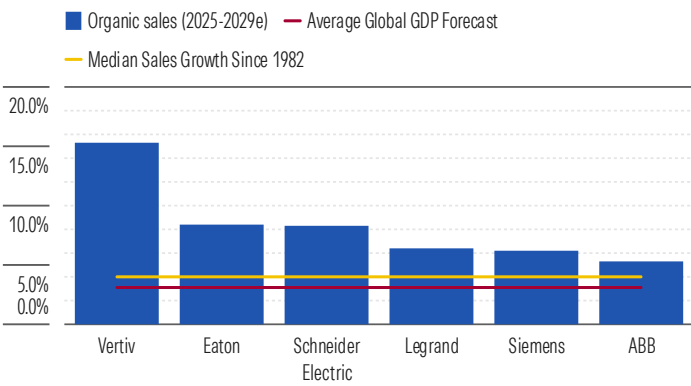
Name/Ticker	Economic Moat	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Morningstar Rating	Market Cap (Bil)
Schneider Electric PAR:SU	Wide	EUR	250.00	250.50	Medium	★★★	141.06
Eaton NYS: ETN	Wide	USD	288.00	373.84	Medium	★★	146.67
Vertiv NYS: VRT	Narrow	USD	119.00	161.59	High	★★	61.72
ABB SWX: ABBN	Wide	CHF	45.50	73.20	Medium	★★	106.21
Legrand PAR: LR	Narrow	EUR	114.00	142.1	Medium	★★	37.25
Johnson Controls NYS: JCI	Narrow	USD	89.00	108.66	Medium	★★	71.11
Trane NYS: TT	Narrow	USD	271.00	452.53	Medium	★	94.24
Carrier NYS: CARR	Narrow	USD	65.00	58.9	Medium	★★★★	50.13
Daikin TKS: 6367	Narrow	JPY	23500.00	17,155.00	Medium	★★★★★	5,110.87
Caterpillar NYS: CAT	Wide	USD	477.00	490.57	Medium	★★★★	229.82
Cummins NYS: CMI	Narrow	USD	420.00	432.59	Medium	★★★★	59.60
Mitubishi Electric TKS: 6503	Narrow	JPY	2650.00	3694.00	Medium	★	7,691.09
nVent Electric NYS: NVT	Narrow	USD	74.00	99.43	Medium	★★	16.00
Siemens ETR: SIE	Wide	EUR	225.00	241.20	Medium	★★★★	188.91
Microsoft NAS: MSFT	Wide	USD	600.00	515.74	Medium	★★★★★	3,833.58
Alphabet NAS: GOOGL	Wide	USD	237.00	245.69	Medium	★★★★	2,971.37
Meta NAS: META	Wide	USD	850.00	727.05	High	★★★★	1,826.45

Exhibit 2 Our Story in Six Charts: Data Center Buildout Boosts Growth for Electrical Equipment Suppliers

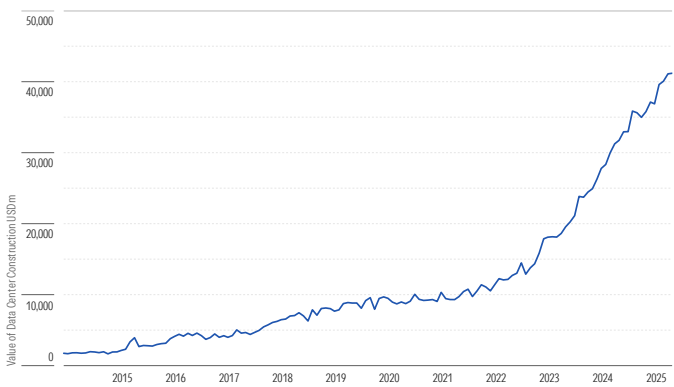
2a: Electric and Power Equipment Is the Largest Non-IT Equipment Cost



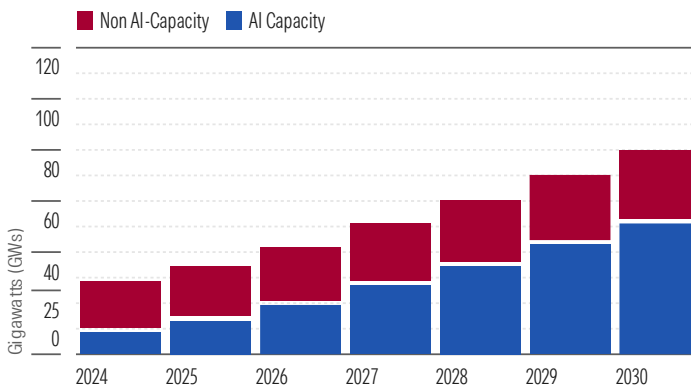
2b: Data Center Demand Lifts Electrical Growth by Up to 5 Times Their Long-Term Average Growth



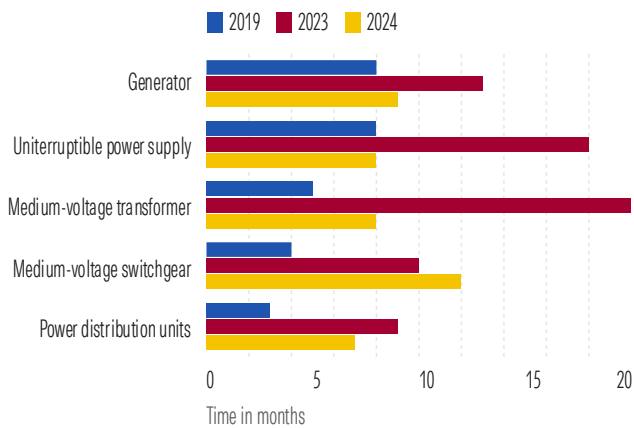
2c: Data Center Construction Continues to Reach Record Levels to Support AI Capabilities



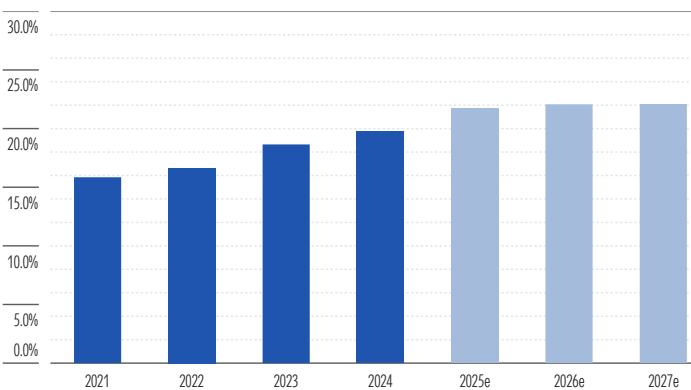
2d: US Data Center Capacity Set To Rise by 3 Times by 2030, Supporting Demand for Power Equipment



2e: High Lead Times Suggest Disciplined Capacity Expansion



2f: Volume Growth and Strong Pricing Will Support Further Operating Margin Expansion

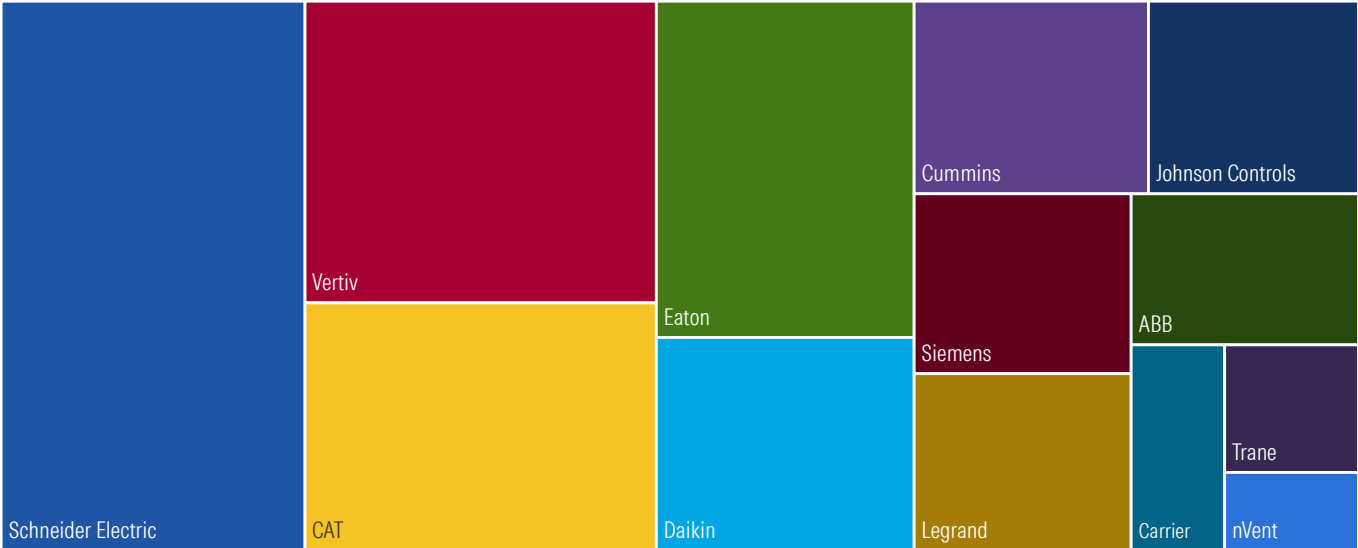


Source: Morningstar.

Electricals Are the Biggest Winners in the Capital Goods Sector From AI Investment

Within the capital goods sector, electrical equipment suppliers earn the most revenue from data centers (Exhibit 3). Schneider Electric leads the sector with approximately \$9.5 billion in data center revenue, over 50% more than the next largest player. Vertiv, which is the closest to being a pure-play data center supplier, ranks second in absolute terms, despite generating over three-quarters of its revenue from data centers. Beyond electrical equipment, data center exposure is concentrated in thermal and backup power. These businesses include HVAC OEMs that supply cooling equipment, such as Carrier, Johnson Controls, Trane, and Daikin, and generator manufacturers, Caterpillar and Cummins, for standby power.

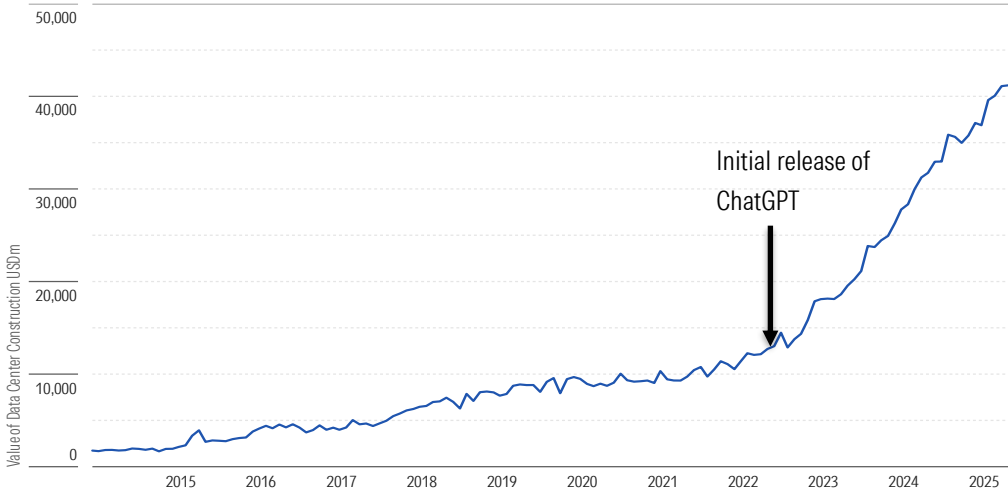
Exhibit 3 Schneider Electric Earns Double the Amount of Revenue From Data Centers Than Any of Its Peers, but Vertiv Is the Closest Pure-Play



Source: Company filings, Morningstar estimates.

Buildings are the largest end market for electrical equipment suppliers, so demand broadly tracks construction activity across commercial buildings, data centers, office buildings, and residential housing. Data centers have been the clear outlier, with spending roughly tripling since early 2023, coinciding with the launch of ChatGPT. In June 2025, data-center construction reached a record seasonally adjusted rate of \$40 billion, 30% higher year over year after a 50% increase in 2024 (Exhibit 4). Investments by hyperscalers to support their generative AI and large-language model capabilities have been the biggest contributor to the record construction levels. The spending flows directly to electrical and power equipment, which accounts for 5%-15% of total data-center construction costs.

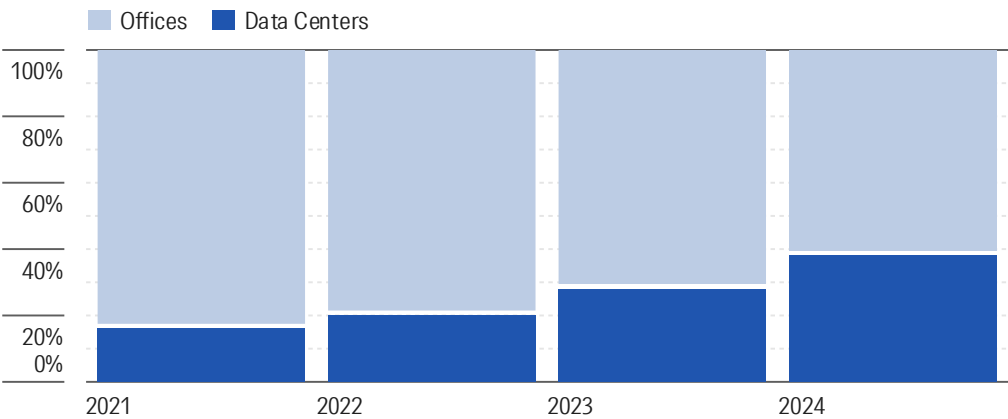
Exhibit 4 Data Center Construction Continues to Reach Record Levels to Support AI Capabilities



Source: US Census Bureau. Data as of September 2025.

According to the US Census Bureau, data centers now account for 40% of US office construction, compared with 15% in 2021 (Exhibit 5), illustrating both the strong growth in data centers and the contraction in spending from other building verticals. Both the relative and absolute strength of the data center versus all other verticals can be illustrated by all of Legrand's 9% organic revenue growth in first-half 2025 being attributable to its 20% exposure to data centers.

Exhibit 5 Data Centers Propel Electrical Equipment Demand, While Office Demand Stalls

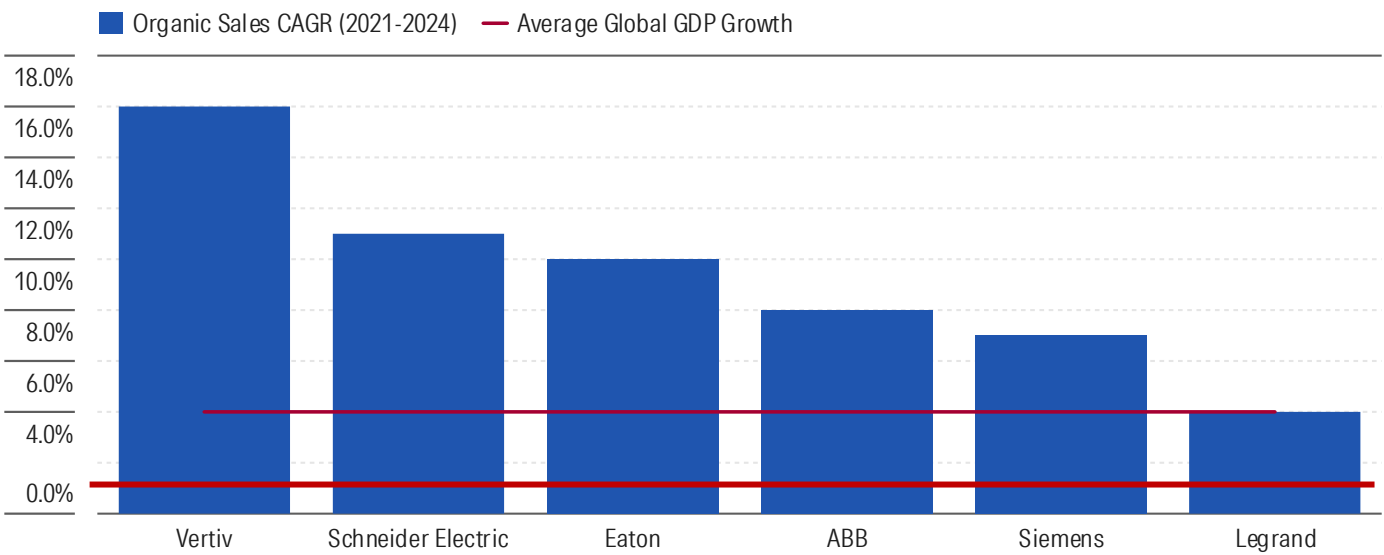


Source: US Census Bureau. Data as of September 2025.

Data center demand has lifted the growth of the electrical equipment suppliers to between 2 and 4 times their long-term average. Historically, their revenue has compounded at approximately 4% since 1982, broadly tracking global GDP growth. By contrast, for most players, growth has been double or more the industry average during the last three years, reflecting the AI-driven investment and the

associated infrastructure needed (Exhibit 6). We anticipate that data center exposure will continue to be highly accretive for the growth prospects of the electrical equipment suppliers.

Exhibit 6 Vertiv, Schneider, and Eaton Have Enjoyed the Highest Growth, Which Corresponds to Their Large Contribution of Sales to Data Centers

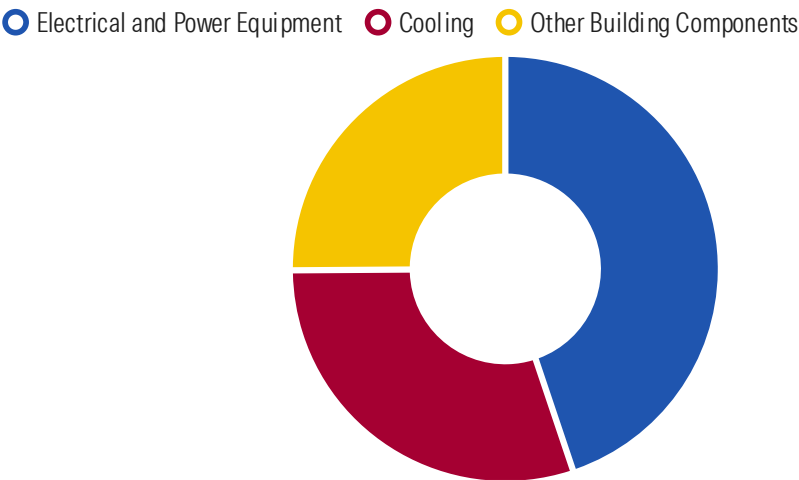


Source: Morningstar estimates, World Bank Group. Data as of October 2025.

Electrical Equipment Is a Critical Component of the Infrastructure Needed to Power AI

Approximately 40% to 45% of non-IT data center equipment spending goes toward power systems, which includes transformers, medium-voltage switchgear, generators, uninterruptible power supplies, and power distribution, making it the biggest non-IT equipment for data center capital expenditure (Exhibit 7).

Exhibit 7 Electric and Power Equipment Is the Largest Non-IT Equipment Cost



Source: SemiAnalysis.

Electrical equipment demand scales roughly with electricity capacity, meaning higher volumes as modern AI data centers need between 2 to 5 times more electrical power than traditional cloud colocation data centers (Exhibit 8). Eaton also estimates that its sales content per megawatt have the potential to double as data centers become more complex and need more sophisticated equipment.

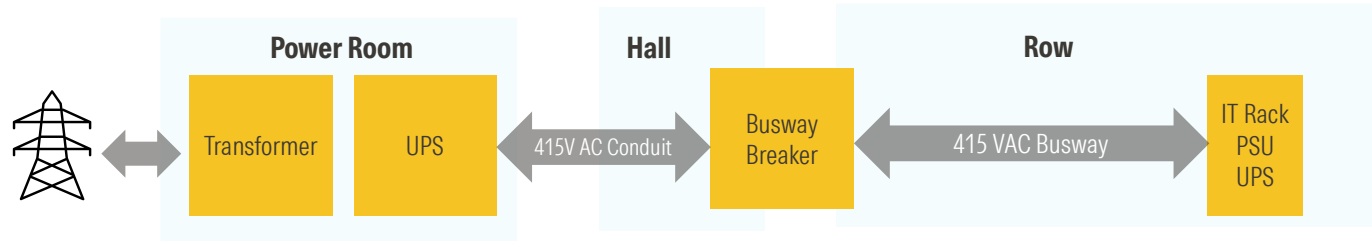
Exhibit 8 AI Data Centers Need 5 Times the Amount of Power as Traditional Data Centers

	Traditional Cloud Colocation	Hybrid Cloud/AI	AI Factory
Density per Rack	8-12 kW	8-130 kW	20-130 kW
Density per Row	250 kW	500 kW	1,250 kW
Racks/Row	~24	~24	~24
Row Density (kW)		2x	2.5x

Source: Vertiv.

The responsibility of electrical equipment is to deliver high amounts of power in an efficient manner to the server racks comprising several IT equipment rooms within a data center, illustrated in the flow diagram below (Exhibit 9). Reliable electrical equipment reduces the risk of costly outages, which can result in significant revenue losses and reputational damage for the data center/hyperscaler, underscoring the critical role that electrical equipment plays.

Exhibit 9 Electrical Equipment Enables the Safe and Effective Transfer of Power Through a Data Center



Source: NVIDIA, SemiAnalysis.

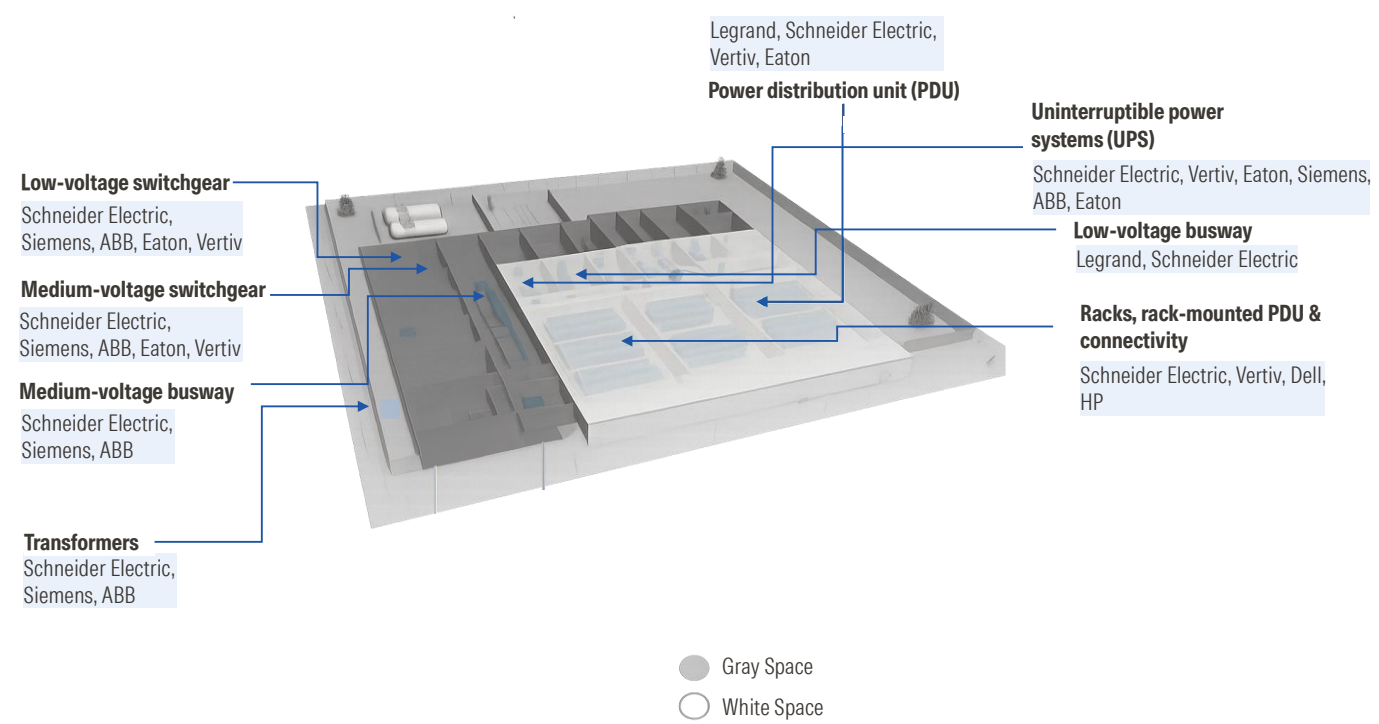
Sophisticated Electrical Equipment Is Needed to Deliver Continuous Power for a Data Center

A data center is a specialized building that houses all the necessary IT infrastructure needed to process, store, and distribute large amounts of data. Cloud computing and AI-based workloads need modern data centers that require sophisticated electrical equipment to deliver reliable power, maintain safety standards, and ensure continuous operation.

The electrical equipment most commonly required within a data center includes uninterruptible power supplies, or UPS, switchgear, power distribution units, or PDU, busways, and rack PDUs, which are supplied by ABB, Eaton, Schneider, Vertiv, and Legrand. Schneider and Vertiv have additional adjacencies in cooling equipment for a data center, too.

Electrical equipment is present throughout a data center, which can be separated between gray and white space (Exhibit 10). The gray space is where the traditional back-end infrastructure of a data center is located, which powers and cools the data center. White space is where the IT equipment and compute infrastructure live, which is ultimately the revenue-generating area of a data center. According to Legrand, the addressable market is EUR 70 billion, comprising EUR 20 billion for the server room (white space) and EUR 50 billion for the gray space.

Exhibit 10 White Space Equipment Has Seen Outsize Growth Due to the Additional Cooling and Power Requirements for AI Data Centers

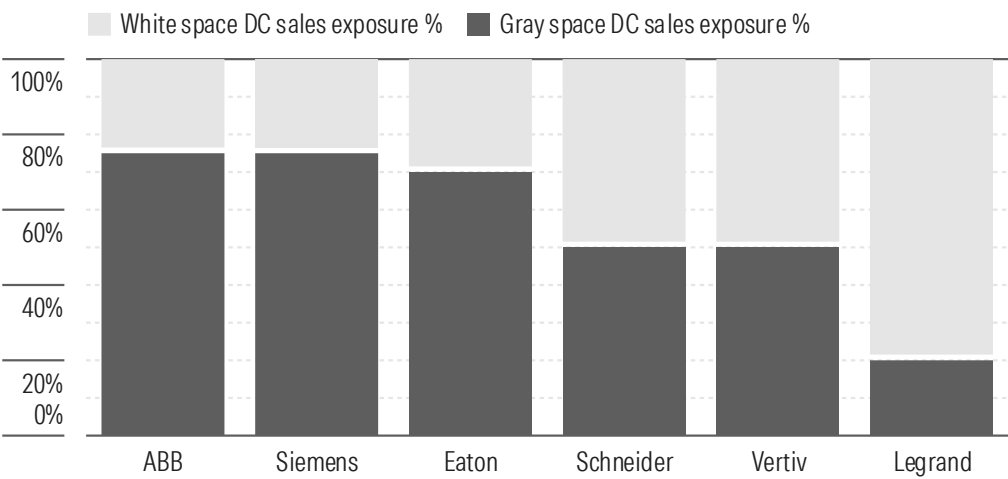


Source: Eaton, Morningstar.

On a company level, Legrand earns the majority of its data center revenue from white space equipment, such as low-voltage busways, uninterruptible power systems, power distribution units, and cabinets and enclosures. Its peers have a more balanced mix of revenue across the data center, given their long-term expertise in supplying customized medium-voltage electrical equipment (Exhibit 11), which has led to a more mixed or slight tilt toward gray space. Traditionally, white space equipment was viewed as more commoditized; however, that has changed with AI data centers requiring more sophisticated equipment

to manage their increased power and cooling needs. The increase in rack density of AI data centers also requires increased interoperability between both areas to improve power efficiency.

Exhibit 11 Schneider and Vertiv Have the Broadest and Most Balanced Portfolios for Data Centers



Source: Company filings, Morningstar estimates.

Uninterruptible Power Supply (UPS) Systems:

Estimated Market Size: \$4 billion to \$7 billion
Largest Suppliers: Schneider Electric, Vertiv, Eaton, ABB.

As is described in its name, the UPS provides critical power continuity within a data center by providing instant backup power that protects data centers from costly power outages. Without it, even a brief outage or voltage dip could cause equipment to crash, resulting in expensive downtime and data loss during power disturbances. Typically, a UPS will provide backup power for between 5 and 10 minutes, which is long enough until the backup generators start and take over the load. Given its critical role, it is common for data centers to have two separate UPS modules per server as backup in case one fails or needs maintenance.

Market share is concentrated with the top three suppliers representing roughly 70% of the market. Schneider Electric is estimated to be the market leader.

AI Implications: Demand to Benefit With Data Center Buildout and Return to Centralized Systems

The extreme power density and critical uptime requirements of AI workloads have increased the importance of UPS systems. To serve workloads on a continuous basis, data centers have stringent redundancy requirements to minimize downtime. For example, data centers classified as Tier 4 (the highest tier) are designed to have 99.999% reliability. The tight density constraints of AI data centers have also seen a shift toward centralized UPS systems from battery backup units that would sit within power shelves. The ongoing shift toward inference workloads is likely to support UPS demand, as uptime is even more critical for real-time inference than for training workloads.

Electrical Switchgear and Distribution Panels:

Estimated Market Size: \$3 billion to \$5 billion

Largest Suppliers: Schneider Electric, Eaton, ABB, Siemens, Vertiv, Legrand

Switchgear is ubiquitous with electricity distribution and forms the backbone of data center power distribution. In the context of data centers, power is received from utilities or transformers, which is then routed throughout the data center. Transformers enable power obtained from the utility to be converted into a lower voltage suitable for a data center, ensuring both safety and minimizing power loss. Each panel and device must be tested to comply with electrical safety standards.

The market size can be roughly split in half between low-voltage and medium-voltage switchgear. Schneider has the broadest product offering across both areas, which explains its leading market share. ABB and Siemens are mostly focused on medium-voltage switchgear, while Legrand and Vertiv are mainly concentrated toward low-voltage switchgear. Vertiv expanded its switchgear portfolio following the acquisition of E&I Engineering in 2021.

AI Implications:

Additional switchgear is required to handle additional power requirements.

Power Distribution Units (PDU):

Estimated Market Size: \$3 billion to \$6 billion

Largest Suppliers: Legrand, Schneider Electric, Vertiv

Power distribution units are the final link in the power chain, which comprises electrical distribution boards that take power from the UPS and feed it to the individual server racks. Each item needs to be extensively tested to ensure reliability under extreme conditions. It is estimated that collectively Legrand, Schneider Electric, and Vertiv have half the market share.

AI Implications: Busway Is the Preferred System for Hyperscalers Over PDUs

AI data centers have seen a shift toward busway systems, which are mounted overhead instead of running dozens of separate cables to each rack from a PDU. Busways are now a preferred solution for hyperscalers, with Legrand enjoying a market-leading position followed by Schneider Electric.

Cooling:

Estimated Market Size: \$16 billion to \$22 billion

Largest Suppliers: Vertiv, Johnson Controls, Trane, Carrier, Schneider, Daikin, nVent

Data center IT equipment is traditionally cooled via air through computer air handling units that are supplied by traditional HVAC businesses, as well as Vertiv. However, high rack densities and hotter AI semiconductors generate more heat, requiring more sophisticated cooling solutions.

AI Implications: Liquid Cooling Has the Brightest Prospects for Non-IT Data Center Equipment

AI servers generate so much energy that they require between 5 to 10 times more cooling per square foot. Using a traditional cooling system to cool a high-density rack can take up one-third of the space of the data center, which has prompted shifts to sophisticated cooling technologies, such as rear-door cooling and direct-to-chip liquid cooling. Given the additional cooling requirements, liquid cooling solutions are the optimal way for data centers to reduce their power usage effectiveness, or PUE, with studies showing that they can reduce energy consumption by up to 40% compared with air cooling.

Rear-door heat exchangers, or RDHXs, are the most similar to conventional cooling technology and are commonly used in space-constrained data centers with a rack density between 40 and 60 kilowatts (kW). Direct-to-chip liquid cooling is optimal in extreme densities and can handle power densities of 60kW to 120kW (Exhibit 12).

Exhibit 12 Liquid Cooling Is the Most Effective Cooling Solution for AI Data Centers



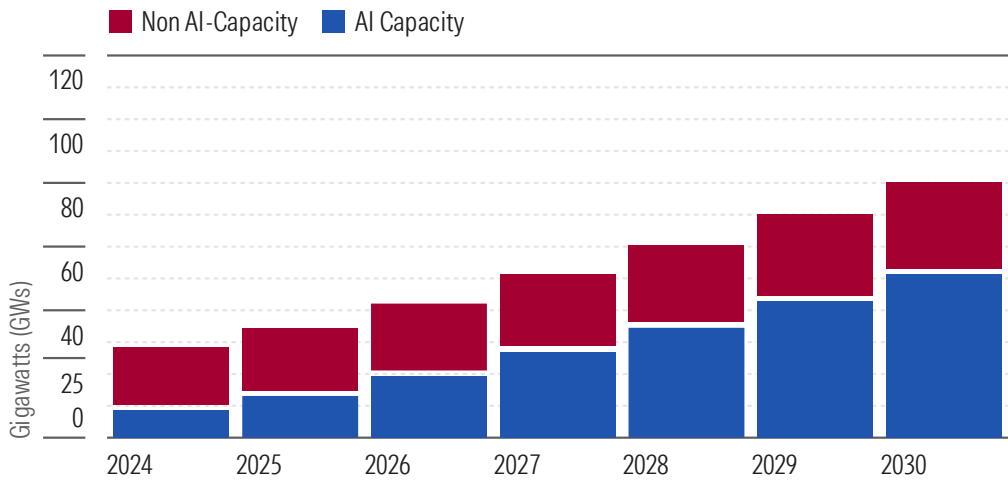
Source: Vertiv, 2025.

Three-Fold Expansion in Data Center Capacity Underpins Medium-Term Growth

We forecast a three-fold increase in US data center capacity by 2030 (Exhibit 13), which is the primary driver behind demand growth for electrical equipment used by data centers. All the electrical equipment suppliers under our coverage earn at least half of their data center revenue from the US, making them direct beneficiaries of the US data center build-out. We estimate that the 60 GW increase in data center capacity will translate to an addressable market exceeding \$100 billion by 2030 for the electrical and power equipment suppliers.

Our expectations for data center capacity fall short of consensus, primarily due to the regulatory challenges faced by electric utilities in increasing their power supplies. For more information on the assumptions behind our US data center forecasts, refer to: [Powering Tomorrow's AI Data Centers](#).

Exhibit 13 US Data Center Capacity Set To Rise by Three Times by 2030, Supporting Demand for Power Equipment



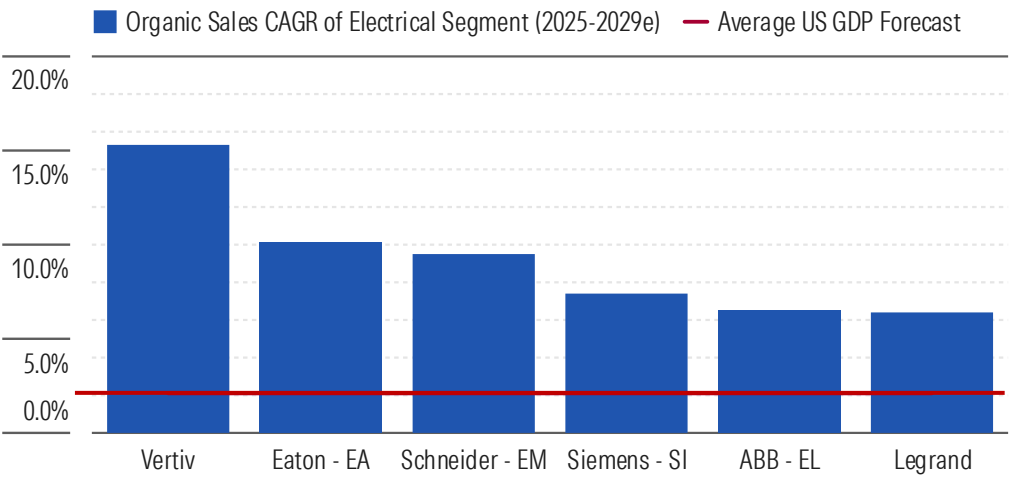
Source: Morningstar.

AI Applications Require New Data Center Buildout and Additional White Space Content

We anticipate that Schneider Electric and Vertiv grow their data center sales at an even faster rate than data center capacity growth, owing to their balanced mix toward the white space of a data center. As the power density of a data center increases, so too does the complexity of white space equipment, as well as the data center's cooling requirements. Vertiv and, to a lesser extent, Schneider, through its acquisition of Motivair, both offer liquid cooling solutions. While Legrand has the biggest exposure to the white space, it faces increasing competition from other electrical equipment incumbents with a broader portfolio as well as Taiwanese suppliers that have shown a willingness to accept lower margins for large volumes.

As mentioned earlier in the report, we expect data center exposure to remain accretive to the revenue growth of electrical equipment suppliers for the foreseeable future and comfortably outperform GDP growth (Exhibit 14). Vertiv's segmental outperformance relative to its peers is attributable to its favorable end market exposure, both toward data centers and the US, compared with its European-listed peers. Legrand's lower growth prospects compared with our estimates for the respective electrical segments of its peers are due to the significant contribution of revenue earned from a soft US office market and the European construction market. Our forecasts also incorporate some conservatism during the latter stages of our estimates, given electricity constraints and permitting issues in Europe.

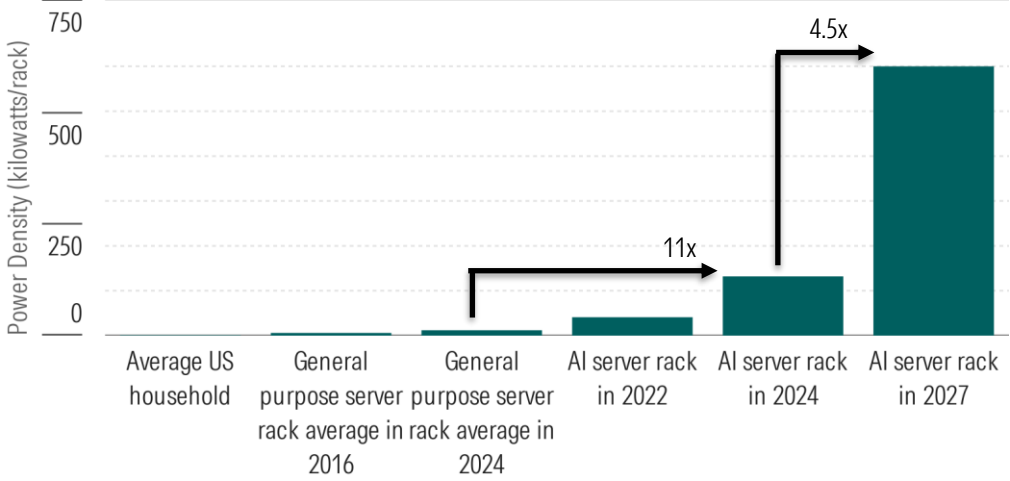
Exhibit 14 Data Center Exposure Will Be Accretive to Electrical Equipment Growth in the Medium Term



AI Workloads Require Data Centers With Significantly Higher Processing Power

The specialized computational demands of AI and large language models require data centers with significantly higher processing power than traditional data centers that are used for more conventional IT tasks, which has created a shift toward server racks with higher power consumption. Modern cloud computing data centers typically operate at a power consumption of 15-20kW per rack, which is approximately 8 times less powerful than a current AI server rack, which has a density of 132 kW. According to Nvidia, power consumption will need to be an additional 4.5 times higher by 2027 (Exhibit 15). Similarly, Legrand predicts that 40% of racks will have power consumption above 20 kilowatts in 2027, compared with 5% in 2019.

Exhibit 15 AI Workloads Require Additional Power Equipment To Handle Their Computing Needs

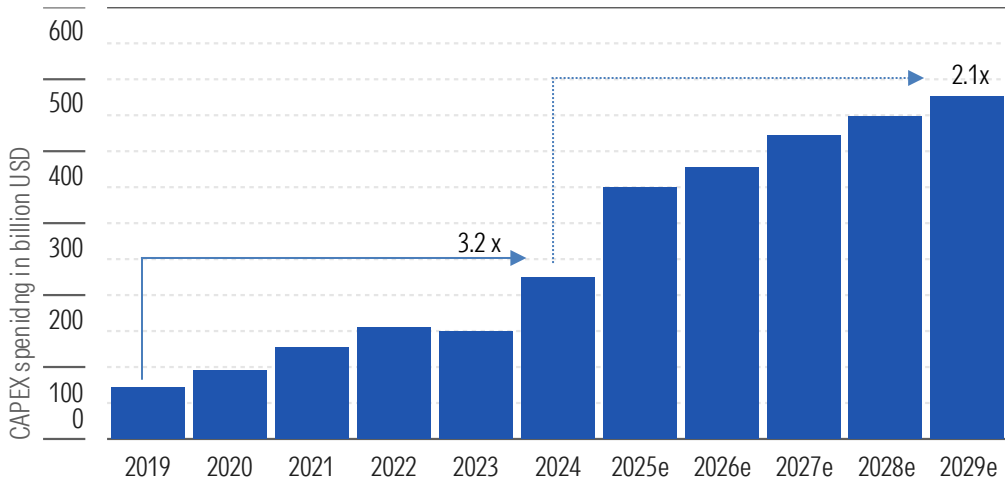


Most existing traditional co-location data centers are not designed for densities above 20 kW per rack, driving the rapid expansion in AI data centers. Our data center capacity forecasts assume a six-fold increase in AI data center capacity, which will account for 64% of data center capacity in the US. Retrofitting existing data centers to accommodate the higher power consumption has proven to be a challenging and costly exercise. In 2022, Meta canceled the expansion of several data centers that were already in development, opting instead for new greenfield construction due to the complexities involved.

Hyperscalers, including Amazon, Google, Microsoft, Meta, and Oracle—which collectively hold nearly 100% of the US cloud market share—have been the primary contributors to the meteoric rise in data center construction spending. Collectively, these five businesses increased their capital expenditure by 3 times between 2019 and 2024, to \$224 billion, primarily to develop, or host, their own generative AI and large language model capabilities. The exuberance in spending can be explained by the CEOs of Alphabet and Meta both highlighting in recent earnings calls that the risk of underinvestment exceeds that of overinvesting.

We anticipate capital expenditure investment to double further through 2029, with the majority of that spending being allocated to data center investments (Exhibit 16). These AI workloads are driving a step-up in the electrical equipment and cooling content per rack. Higher data center capacity and denser racks are lifting demand for white space UPS and busways, alongside growing adoption of liquid cooling systems.

Exhibit 16 Five US Hyperscalers Have Been the Biggest Contributors to the Expansion of Data Centers

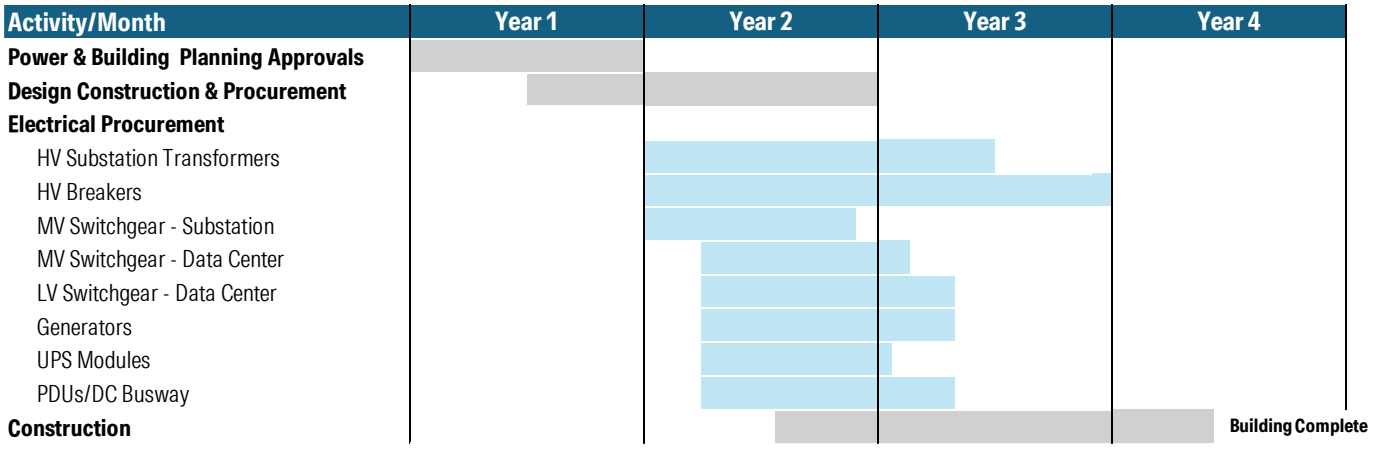


Source: Company filings, Morningstar estimates.

Upward revisions and a constant stream of new project announcements bode well for the medium-term visibility for electrical equipment suppliers. Electrical equipment is typically installed during the second year of data center construction. Therefore, recent announcements in September, such as new sites as part of the \$500 billion "Stargate project" for OpenAI, Oracle, and Softbank, as well as the \$600 billion announced by Meta at the White House, will not be included in the revenue of any of the electrical

suppliers (Exhibit 17). According to Eaton, the current US data center construction backlog represents approximately seven years of construction at the 2024 build rates, highlighting both the current scale of investment and how it benefits the medium-term growth prospects for electrical equipment suppliers.

Exhibit 17 Recent Announcements of New Hyperscale Projects Will Still Flow Across the Supply Chain

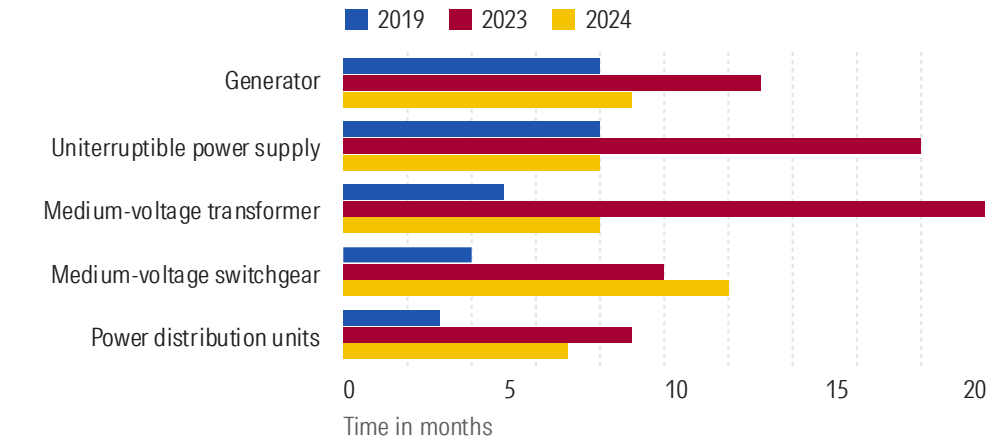


Source: Rosendin Electric.

Surging Demand Has Created a Favorable Environment for Rising Profit Margins

Component constraints and extended lead times have supported pricing power and record margins across electrical-equipment suppliers. While lead times have eased (in some product categories) since the disruptions during the pandemic, they remain elevated due to the surge in demand from data centers (Exhibit 18). Manufacturers have been expanding capacity, most notably in the US, to satisfy higher demand, but these have been gradual additions to avoid overbuilding and protect returns.

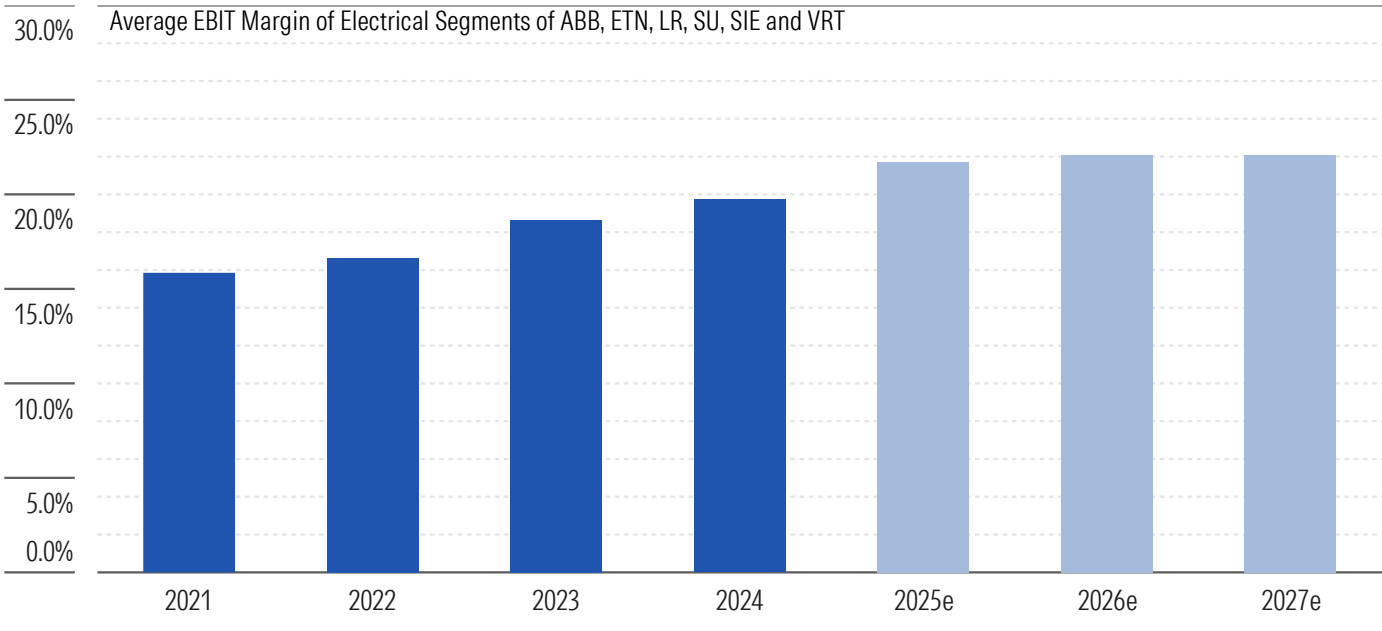
Exhibit 18 Elevated Lead Times Highlight the Surge in Demand From Data Centers and Suggest Only Gradual Capacity Expansion



Source: McKinsey & Company, Cushman & Wakefield Research, Turton Bond.

Rising demand, tight supply, and a relatively concentrated group of suppliers provide a healthy environment for operating margins to continue to increase. On average, operating margins for the respective electrical segments have increased by close to 400 basis points since 2024 (Exhibit 19). We expect further increases of approximately 250 basis points, driven by high volumes and strong pricing. Greater sophistication in white space equipment for high-density data centers, where uptime and reliability are even more paramount, alongside the shift toward prefabricated solutions, helps strengthen pricing power for Western suppliers. These trends also reduce the threat from Taiwanese competitors that historically competed on price in commoditized product categories. We expect Vertiv to enjoy the biggest improvement in profitability, given its superior revenue growth.

Exhibit 19 We Expect Operating Margins for the Electrical Equipment Suppliers to Continue to Rise Given High Demand and Strong Pricing Power



Source: Morningstar estimates. Data as of October 2025.

Risk of Data Center Demand Not Materializing Is Mitigated for Electricals

We view the electrical equipment suppliers to be relatively well insulated if data center expansion falls short of bullish expectations. First, from a top-down perspective, our data center capacity outlook is more conservative than the consensus (refer to: [Powering Tomorrow's AI Data Centers](#)). We also model considerably lower deployment in Europe, due to permitting and grid bottleneck challenges.

Second, product mix also limits excess inventory risk. Most data center power equipment is also used across industrial and commercial buildings, lowering the risk of manufacturers carrying excessive inventory. For example, the same factory that manufactures switchgear for data centers will also supply other customers, with the data center difference being heavier use of prefabricated/modular solutions to expedite construction times. Cooling is the one exception and has the most data center-specific exposure, where Vertiv will be most affected if AI data center growth fails to materialize. Lastly, we see

no evidence that electrical equipment suppliers are expanding their capacity at an overly ambitious rate, as announced expansions have been staged and lead times remain elevated.

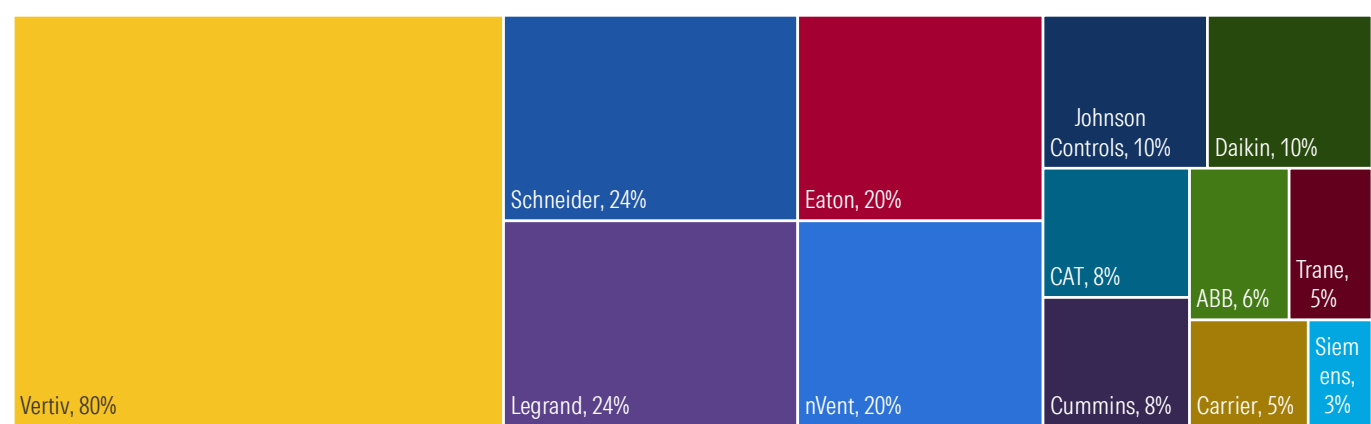
Hyperscalers also see multiple use cases for the underlying infrastructure. According to the CEO of Alphabet, Sundar Pichai, during the firm's second-quarter 2024 earnings call: "The one way I think about it is when you go through a curve like this, the risk of underinvesting is dramatically greater than the risk of overinvesting for us here. Even in scenarios where if it turns out we are overinvesting, these are infrastructure which are widely useful for us, they have long useful lives, and we can apply it across and we can work through that."

What's an Equity Investor To Do?

The electrical equipment suppliers have the largest direct exposure to data centers (Exhibit 20) within the capital goods sector. Eaton, Legrand, nVent, and Schneider Electric each earn between 20% and 25% of their revenue from data centers, while Vertiv is the closest in the sector to being a pure-play supplier with 80% of its revenue tied to data centers. ABB and Siemens have immaterial exposure due to their conglomerate status, despite earning a similar amount of revenue from data centers as their peers. HVAC OEMs (Carrier, Johnson Controls, Trane, and Daikin) and manufacturers of generators (Caterpillar and Cummins) are the only other businesses in the capital goods sector with data center exposure worth highlighting, but with smaller contributions of between 5% and 10%.

Schneider Electric and Vertiv are the two best-placed businesses to benefit from the AI theme within the capital goods sector, owing to their broad product offering inside the data center and large end market exposure. At a PE multiple of 28 times on 2025 earnings, Schneider is trading at a more reasonable valuation than Vertiv, which is trading at a 44 times PE multiple.

Exhibit 20 Vertiv Is the Closest To Being a Pure-Play Data Center Supplier, Underpinning Its Superior Growth Estimates



Source: Company filings, Morningstar estimates.

We see few investment opportunities at present, given our somewhat conservative outlook on data center capacity versus market consensus and the market having snatched up any opportunities at any

picks-and-shovel businesses for the AI theme. Daikin is the only undervalued business in the capital goods sector with data center exposure above 10%.

Well-Positioned and Fairly Valued:

Schneider Electric (Electrical Equipment) (PAR: SU)					
	Market Cap	Moat Rating	Last Close	Fair Value Est.	Rating
P/FV	141b EUR	Wide	250.00	250.00	★★★
	Schneider Electric is the largest supplier of critical electrical equipment to data centers, earning more than double the amount from its closest peer. With one-quarter of its sales being generated from data centers, it's well positioned for the expansion of data center capacity. Beyond data centers, the business also benefits from other secular growth themes such as grid modernization and the electrification of the industrial sector which underpins our 13% annualized EPS growth during the next five years. Shares are currently fairly valued.				

Well-Positioned and Overvalued:

Vertiv (NYS: VRT)					
	Market Cap	Moat Rating	Last Close	Fair Value Est.	Rating
P/FV	61b USD	Narrow	158.87	119.00	★★
	Vertiv is the closest to being a pure-play data center supplier in the capital goods sector and enjoys the brightest growth prospects. Its liquid-cooling solutions are well positioned to benefit from the expansion of AI data centers, underpinning its superior growth outlook versus its peers. We believe that the market recognizes Vertiv as a picks-and-shovel for the AI theme, with shares appearing to be richly valued.				

Undervalued With Limited Exposure:

Daikin Industries (TKS: 6367)					
	Market Cap	Moat Rating	Last Close	Fair Value Est.	Rating
P/FV	5278b JPY	Narrow	17,870.00	23,500.00	★★★★
1.75	Daikin is the only undervalued business in the capital goods sector with data center exposure above 10%. Daikin's commercial and applied air conditioning products have benefited from the rising demand for data centers. As cooling equipment is essential for data centers' operation, Daikin has seen robust growth in related products since 2023, particularly in North America. Its segment margin has also improved thanks to the ramping up of more profitable service income. We expect sales to data centers to keep supporting Daikin's earning growth over the next few years.				
1.50					
1.25					
1.00					
0.75					
0.50					
0.25					



Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. We think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (mines, for example), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss short-term market-price movements), but we believe these negatives are mitigated by deep analysis and our long-term approach.

Morningstar's Equity Research Group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating:

- ▶ our assessment of the firm's economic moat.
- ▶ our estimate of the stock's fair value.
- ▶ our uncertainty around that fair value estimate.
- ▶ the current market price.

This process ultimately culminates in our single-point star rating.

Economic Moat

The Morningstar Economic Moat Rating is a structural feature that Morningstar believes positions a firm to earn durable excess profits over a long period of time, with excess profits defined as returns on invested capital above our estimate of a firm's cost of capital. The economic moat rating is not an indicator of the investment performance of the investment highlighted in this report. Narrow-moat companies are those that Morningstar believes are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those that Morningstar believes will earn excess returns for 10 years, with excess returns more likely than not to remain for at least 20 years. Firms without a moat, including those that have a substantial threat of value destruction-related risks related to environmental, social, and governance; industry disruption; financial health; or other idiosyncratic issues, are more susceptible to competition. Morningstar has identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Fair Value Estimate

Each stock's fair value is estimated by using a proprietary discounted cash flow model, which assumes that the stock's value is equal to the total of the free cash flows of the company is expected to generate in the future, discounted back to the present at the rate commensurate with the riskiness of the cash flows. As with any DCF model, the ending value is highly sensitive to Morningstar's projections of future growth.

Fair Value Uncertainty

The Morningstar Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the fair value estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, exposure to material ESG risks, and other company-specific factors. Based on these factors, analysts classify the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. Our recommended margin of safety—the discount to fair value demanded before we'd recommend buying or selling the stock—widens as our uncertainty of the estimated value of the equity increases.

Market Price

The market prices used in this analysis and noted in the report come from exchanges on which the stock is listed, which we believe is a reliable source.

Morningstar Rating for Stocks

The Morningstar Rating for Stocks is a forward-looking, analyst-driven measure of a stock's current price relative to the analyst's estimate of what the shares are worth. Stock star ratings indicate whether a stock, in the equity analyst's educated opinion, is cheap, expensive, or fairly priced. To rate a stock, analysts estimate what they think it is worth (its "fair value"), using a detailed, long-term cash flow forecast for the company. A stock's star rating depends on whether its current market price is above or below the fair value estimate. Those stocks trading at large discounts to their fair values receive the highest ratings (4 or 5 stars). Stocks trading at large premiums to their fair values receive lower ratings (1 or 2 stars). A 3-star rating means the current stock price is close to the analyst's fair value estimate.

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