

Effect of suspension not clear yet Real estate business also warrants attention

Investment stance: we reiterate Neutral rating, effect of suspension in Jul-Sep still unclear

In Apr-Jun 2016, operating losses narrowed to ¥0.3bn, from ¥0.6bn the year earlier, although Apr-Jun results make only a small contribution to full-year results owing to seasonal factors. Losses narrowed owing to an increase in revenues in the machinery systems business, offsetting an increase in provisions against construction losses in the facilities construction business, which includes the HVAC systems for buildings business. As announced by the company on 23 June, the government suspended the company from participating in bids and contracts for 30 days, from 8 July to 6 August, in connection with antitrust law violations. We will be paying close attention to the effect of the suspension on earnings in Jul-Sep and beyond. Peers that were similarly suspended in 15/3 saw earnings adversely affected in cases where the companies also refrained from actively taking on work in the private sector. We make no change to our operating profit forecasts, but we lower our target price as we cut our target P/E to 11-12x, from 16-17x previously, to reflect trends in the benchmark P/E and other factors.

Favorable order receipt conditions

In Apr-Jun, order receipts in the facilities construction business rose 25% y-y. In the industrial HVAC business, which tends to be sensitive to slowdowns in economic activity via declines in capex at client companies, order receipts rose 28% y-y, the seventh straight quarter of growth. In the HVAC & plumbing for buildings business, order receipts rose 45%, although we think margins are unfavorable on some of the orders.

Company still weighing real estate investment policy

The company plans to occupy a portion and rent out to tenants a portion of a property it owns in Yamato, Kanagawa Prefecture. The company has yet to determine capex for the part of the property it plans to occupy.

Cons	16/3		17/3E		18/3E		19/3E	
	Actual	Old	New	Co's	Old	New	Old	New
Currency: JPY								
Sales (mn)	178,901	190,000	187,000	185,000	193,000	189,000	N/A	191,000
Ope profits (mn)	6,509	6,500	6,500	6,500	7,000	7,000	N/A	7,000
EPS	83.8	70.8	78.7	77.1	78.7	86.5	N/A	86.5
P/E (x)	9.6	11.4	10.2	N/A	10.2	9.3	N/A	9.3
EV/EBITDA (x)	3.5	3.6	2.5	N/A	2.6	1.8	N/A	1.2
P/B (x)	0.6	0.6	0.6	N/A	0.5	0.6	N/A	0.5
Dividend yield (%)	3.7	2.2	2.5	N/A	2.2	2.7	N/A	2.7

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Global Markets Research

29 August 2016

Rating Remains	Neutral
Target Price Reduced from 1,133	JPY 905
Closing price 26 August 2016	JPY 804
Potential upside	+12.6%

Anchor themes

Margins on systems for office buildings in Japan have been improving. Demand for industrial HVAC systems has also been favorable despite an uncertain outlook. Although demand on overseas markets and emerging markets in particular has shown signs of slowing, we expect capex to remain firm in Japan.

Catalyst

Catalysts we see include improvement in margins, chiefly in HVAC systems for buildings, order receipts in the industrial HVAC systems and other businesses, and clearer plans in the real estate business for replacing major tenants that are relocating.

Research analysts

Japan construction

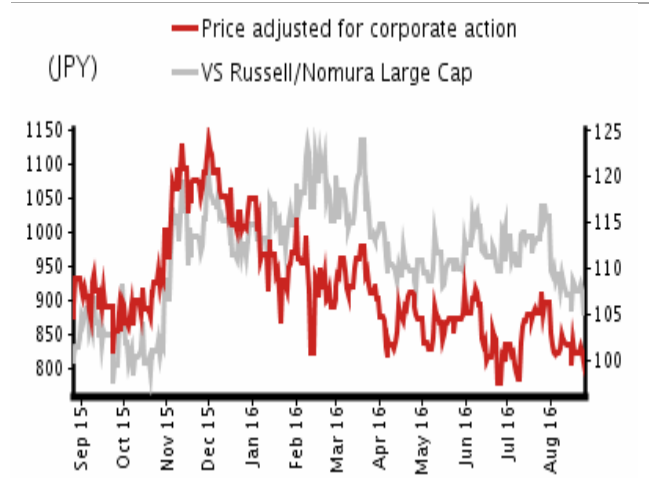
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Key data on Sanki Engineering

Rating

Stock	Neutral
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Relative performance chart



Source: ThomsonReuters, Nomura research

Performance

(%)	1M	3M	12M
Absolute	-8.6	-7.9	-8.3
Relative to Russell/Nomura Large Cap	-7.6	-4.2	5.2

Stock price data

Current stock price (JPY)	804
Market capitalization (JPY bn)	53.6
52-week low stock price (JPY)	765
52-week high stock price (JPY)	1,155
Shares out (mn)	66.7

Source: ThomsonReuters, Nomura research

Valuation and ratio analysis

(JPY)	16/3	17/3E	18/3E	19/3E
EPS	83.8	78.7	86.5	86.5
BPS or NAV per share	1,328.6	1,375.1	1,441.2	1,505.7
DPS	30.0	20.0	22.0	22.0
ROE (%)	6.3	5.8	6.1	5.9

Income statement

(JPY mn)	16/3	17/3E	18/3E	19/3E
Sales	178,901	187,000	189,000	191,000
Operating profits	6,509	6,500	7,000	7,000
EBITDA	7,232	7,200	7,800	7,900
Interest & dividend income	706	650	650	650
Interest expense	86	50	50	50
Recurring profits	8,135	7,000	7,500	7,500
Pretax profits	7,834	7,000	7,500	7,500
Minority interest	17	0	0	0
Profits attributable to owners of parent	5,327	5,000	5,500	5,500
(Equity in net income of affiliates)	771	0	0	0

Balance sheet

(JPY mn)	16/3	17/3E	18/3E	19/3E
Current assets	115,491	130,400	135,200	140,100
Operating receivables	75,513	78,000	79,000	79,000
Inventories	2,736	3,500	3,500	3,500
Long-term assets	53,932	53,800	54,000	54,100
Total assets	169,423	184,200	189,200	194,200
Operating payables (Current)	51,460	59,000	60,000	61,000
Interest-bearing debt	6,637	7,000	7,000	7,000
Total liabilities	84,865	96,800	97,600	98,500
Net assets	84,557	87,400	91,600	95,700
Shareholders' equity	84,436	87,400	91,600	95,700

Cash flow statement

(JPY mn)	16/3	17/3E	18/3E	19/3E
Operating cash flow	5,220	9,300	6,100	7,300
Profits attributable to owners of parent	5,327	5,000	5,500	5,500
Depreciation	723	700	800	900
Change in working capital	-2,591	4,289	0	1,000
Investment cash flow	5,520	-300	-1,000	-1,000
Capex	-45	-300	-1,000	-1,000
Free cash flow	10,740	9,000	5,100	6,300
Financial cash flow	-1,826	-1,600	-1,300	-1,400
Change in interest-bearing debt	-199	363	0	0
Dividend payments	-1,366	-2,000	-1,300	-1,400
Change in cash & equivalents	8,833	7,400	3,800	4,900

Source: Company data, Nomura estimates

Fig. 1: Sanki Engineering [1961]: consolidated financial data

				(¥mn, except where noted)					
Consolidated orders	14/3	15/3	16/3	New 17/3E	Old 17/3E	New 18/3E	Old 18/3E	New 19/3E	Co's 17/3E
Total orders	168,295	173,398	183,270	182,000	194,000	186,000	197,000	186,000	183,000
% y-y	1.5	3.0	5.7	-0.7	5.9	2.2	1.5	0.0	-0.1
Facilities construction	143,839	150,032	152,432	152,000	164,000	156,000	167,000	156,000	149,900
% y-y	5.7	4.3	1.6	-0.3	7.6	2.6	1.8	0.0	-1.7
Plant systems	23,512	22,483	29,919	29,000	29,000	29,000	29,000	29,000	31,500
% y-y	-14.3	-4.4	33.1	-3.1	-3.1	0.0	0.0	0.0	5.3
Machinery systems	8,482	5,716	10,309	9,000	9,000	9,000	9,000	9,000	9,500
Environmental systems	15,029	16,767	19,610	20,000	20,000	20,000	20,000	20,000	22,000
Real estate	1,077	1,285	1,532	1,000	1,000	1,000	1,000	1,000	1,600
% y-y	-60.8	19.3	19.2	-34.7	-34.7	0.0	0.0	0.0	4.4
Consolidated segment data									
Sales	171,496	179,598	178,901	187,000	190,000	189,000	193,000	191,000	185,000
% y-y	10.9	4.7	-0.4	4.5	6.2	1.1	1.6	1.1	3.4
Facilities construction	143,697	151,169	149,952	156,400	160,000	158,400	163,000	160,400	154,900
% y-y	12.0	5.2	-0.8	4.3	6.7	1.3	1.9	1.3	3.3
Plant systems	27,015	27,439	27,951	29,000	29,000	29,000	29,000	29,000	28,500
% y-y	14.2	1.6	1.9	3.8	3.8	0.0	0.0	0.0	2.0
Machinery systems	9,846	9,953	9,217	9,000	9,000	9,000	9,000	9,000	9,500
Environmental systems	17,169	17,485	18,734	20,000	20,000	20,000	20,000	20,000	19,000
Real estate	1,077	1,285	1,532	1,600	1,000	1,600	1,000	1,600	1,600
% y-y	-60.8	19.3	19.2	4.4	-34.7	0.0	0.0	0.0	4.4
Recurring profits	3,146	3,809	8,135	7,000	7,000	7,500	7,500	7,500	7,000
% y-y	17.4	21.1	113.6	-14.0	-14.0	7.1	7.1	0.0	-14.0
Facilities construction	3,260	2,943	7,698	5,900	5,900	6,400	6,400	6,400	-
% y-y	172.6	-9.7	161.6	-23.4	-23.4	8.5	8.5	0.0	-
Plant systems	-310	129	-40	400	400	400	400	400	-
% y-y	-	-141.6	-	-1,100.0	-1,100.0	0.0	0.0	0.0	-
Machinery systems	-287	105	275	300	300	300	300	300	-
Environmental systems	-23	24	-315	100	100	100	100	100	-
Real estate	147	207	233	200	200	200	200	200	-
% y-y	-88.7	-	12.6	-	-	-	-	-	-
Recurring margin (%)	1.8	2.1	4.5	3.7	3.7	4.0	3.9	3.9	3.8
Facilities construction	2.3	1.9	5.1	3.8	3.7	4.0	3.9	4.0	-
Plant systems	-1.1	0.5	-0.1	1.4	1.4	1.4	1.4	1.4	-
Real estate	13.6	16.1	15.2	12.5	20.0	12.5	20.0	12.5	-

Source: Company data, Nomura estimates

Fig. 2: Sanki Engineering [1961]: consolidated financial data (quarterly)

Consolidated orders	14/3				15/3				16/3				17/3
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Total orders	40,928	45,741	35,543	46,083	42,489	38,759	55,924	36,226	46,385	52,821	48,311	35,753	55,338
% y-y	5.5	5.3	-3.3	-1.5	3.8	-15.3	57.3	-21.4	9.2	36.3	-13.6	-1.3	19.3
Facilities construction	34,783	40,209	28,513	40,334	37,434	32,516	48,739	31,343	36,677	41,965	43,830	29,960	45,871
% y-y	3.3	11.6	1.3	5.3	7.6	-19.1	70.9	-22.3	-2.0	29.1	-10.1	-4.4	25.1
Plant systems	5,894	5,270	6,743	5,605	4,813	6,046	6,904	4,720	9,320	10,795	4,239	5,565	9,489
% y-y	29.6	-23.0	-16.5	-29.7	-18.3	14.7	2.4	-15.8	93.6	78.5	-38.6	17.9	1.8
Machinery systems	3,085	1,538	2,314	1,545	1,579	1,309	1,604	1,224	4,477	2,504	1,703	1,625	2,030
Environmental systems	2,809	3,731	4,430	4,059	3,233	4,738	5,300	3,496	4,842	8,291	2,537	3,940	7,459
Real estate	269	269	269	270	270	280	362	373	381	385	382	384	388
% y-y	-60.7	-60.8	-60.9	-60.7	0.4	4.1	34.6	38.1	41.1	37.5	5.5	2.9	1.8
Consolidated segment data													
Sales	29,463	37,545	41,281	63,207	32,825	42,682	47,146	56,945	34,495	40,985	47,023	56,398	33,866
% y-y	-0.4	9.3	7.9	20.5	11.4	13.7	14.2	-9.9	5.1	-4.0	-0.3	-1.0	-1.8
Facilities construction	25,822	31,984	33,922	51,969	28,365	36,384	39,466	46,954	30,213	35,168	38,286	46,285	28,653
% y-y	4.6	10.0	8.0	20.3	9.8	13.8	16.3	-9.6	6.5	-3.3	-3.0	-1.4	-5.2
Plant systems	3,416	5,405	7,189	11,005	4,202	6,063	7,428	9,746	3,918	5,523	8,408	10,102	5,010
% y-y	-20.1	14.3	15.1	31.0	23.0	12.2	3.3	-11.4	-6.8	-8.9	13.2	3.7	27.9
Machinery systems	1,832	2,430	2,462	3,122	2,061	2,803	2,573	2,516	1,587	1,720	2,504	3,406	2,434
Environmental systems	1,584	2,975	4,727	7,883	2,141	3,260	4,855	7,229	2,331	3,803	5,904	6,696	2,576
Real estate	269	269	269	270	270	280	362	373	381	385	382	384	388
% y-y	-60.7	-60.8	-60.9	-60.7	0.4	4.1	34.6	38.1	41.1	37.5	5.5	2.9	1.8
Recurring profits	-1,713	-407	568	4,698	-1,846	-479	1,612	4,522	-254	778	2,555	5,056	27
% y-y	-	-	-5.3	24.1	-	-	183.8	-3.7	-	-	58.5	11.8	-
Facilities construction	-1,249	-541	434	4,616	-1,363	-648	1,024	3,930	121	745	2,003	4,829	46
% y-y	-	-	203.5	40.6	-	-	135.9	-14.9	-	-	95.6	22.9	-62.0
Plant systems	-746	-415	60	791	-761	-224	208	906	-860	-332	248	904	-425
% y-y	-	-	-	85.7	-	-	246.7	14.5	13.0	-	19.2	-0.2	-
Machinery systems	-68	-82	-8	-129	-138	84	74	85	-171	-80	174	352	121
Environmental systems	-678	-333	68	920	-623	-308	134	821	-689	-	74	552	-
Real estate	17	44	53	33	58	53	65	31	66	48	50	69	62
% y-y	-95.2	-87.1	-82.0	-89.6	241.2	20.5	22.6	-6.1	13.8	-9.4	-23.1	122.6	-6.1
Recurring margin (%)	-5.8	-1.1	1.4	7.4	-5.6	-1.1	3.4	7.9	-0.7	1.9	5.4	9.0	0.1
Facilities construction	-4.8	-1.7	1.3	8.9	-4.8	-1.8	2.6	8.4	0.4	2.1	5.2	10.4	0.2
Plant systems	-21.8	-7.7	0.8	7.2	-18.1	-3.7	2.8	9.3	-21.9	-6.0	2.9	8.9	-8.5
Real estate	6.3	16.4	19.7	12.2	21.5	18.9	18.0	8.3	17.3	12.5	13.1	18.0	16.0
Consolidated income statement													
Sales	29,463	37,545	41,281	63,207	32,825	42,682	47,146	56,945	34,495	40,985	47,023	56,398	33,866
% y-y	-0.4	9.3	7.9	20.5	11.4	13.7	14.2	-9.9	5.1	-4.0	-0.3	-1.0	-1.8
Gross profits	1,771	3,382	4,134	9,136	1,700	3,225	4,753	8,288	3,291	4,812	6,043	8,783	3,905
% y-y	-26.1	7.5	-4.3	18.2	-4.0	-4.6	15.0	-9.3	93.6	49.2	27.1	6.0	18.7
Margin (%)	6.0	9.0	10.0	14.5	5.2	7.6	10.1	14.6	9.5	11.7	12.9	15.6	11.5
Operating profits	-2,037	-503	554	4,804	-2,085	-620	1,201	4,455	-630	806	2,260	4,073	-265
% y-y	-	-	-16.4	31.2	-	-	116.8	-7.3	-	-	88.2	-8.6	-
Margin (%)	-6.9	-1.3	1.3	7.6	-6.4	-1.5	2.5	7.8	-1.8	2.0	4.8	7.2	-0.8
Recurring profits	-1,713	-407	568	4,698	-1,846	-479	1,612	4,522	-254	778	2,555	5,056	27
% y-y	-	-	-5.3	24.1	-	-	183.8	-3.7	-	-	58.5	11.8	-
Margin (%)	-5.8	-1.1	1.4	7.4	-5.6	-1.1	3.4	7.9	-0.7	1.9	5.4	9.0	0.1
Profits attributable to owners of parent	-1,043	-244	363	2,687	-1,215	-112	1,120	2,668	-266	521	1,790	3,282	-2
% y-y	-	-	45.8	-	-	-	208.5	-0.7	-	-	59.8	23.0	-
Margin (%)	-3.5	-0.6	0.9	4.3	-3.7	-0.3	2.4	4.7	-0.8	1.3	3.8	5.8	0.0

Source: Nomura, based on company data

Fig. 3: Sanki Engineering [1961]: consolidated financial data (1)

				(¥mn, except where noted)					
Consolidated income statement	14/3	15/3	16/3	New 17/3E	Old 17/3E	New 18/3E	Old 18/3E	New 19/3E	Co's 17/3E
Sales	171,496	179,598	178,901	187,000	190,000	189,000	193,000	191,000	185,000
% y-y	10.9	4.7	-0.4	4.5	6.2	1.1	1.6	1.1	3.4
Value of completed projects	170,336	178,220	177,262	185,400	189,000	187,400	192,000	189,400	183,000
% y-y	12.1	4.6	-0.5	4.6	6.6	1.1	1.6	1.1	0.0
Development business	1,159	1,378	1,638	1,600	1,000	1,600	1,000	1,600	1,000
% y-y	-57.8	18.9	18.9	-2.3	-38.9	0.0	0.0	0.0	0.0
Gross profits	18,423	17,966	22,929	23,000	21,900	23,500	22,400	23,500	23,000
% y-y	4.7	-2.5	27.6	0.3	-4.5	2.2	2.3	0.0	0.3
Margin (%)	10.7	10.0	12.8	12.3	11.5	12.4	11.6	12.3	12.4
Completed projects	18,111	17,648	22,556	22,600	21,600	23,100	22,100	23,100	22,650
% y-y	12.1	-2.6	27.8	0.2	-4.2	2.2	2.3	0.0	0.4
Margin (%)	10.6	9.9	12.7	12.2	11.4	12.3	11.5	12.2	12.4
Development business	311	318	373	400	300	400	300	400	350
% y-y	-78.2	2.3	17.3	7.2	-19.6	0.0	0.0	0.0	-6.2
Margin (%)	26.8	23.1	22.8	25.0	30.0	25.0	30.0	25.0	17.5
Operating profits	2,818	2,951	6,509	6,500	6,500	7,000	7,000	7,000	6,500
% y-y	17.9	4.7	120.6	-0.1	-0.1	7.7	7.7	0.0	-0.1
Margin (%)	1.6	1.6	3.6	3.5	3.4	3.7	3.6	3.7	3.5
Recurring profits	3,146	3,809	8,135	7,000	7,000	7,500	7,500	7,500	7,000
% y-y	17.4	21.1	113.6	-14.0	-14.0	7.1	7.1	0.0	-14.0
Margin (%)	1.8	2.1	4.5	3.7	3.7	4.0	3.9	3.9	3.8
Profits attributable to owners of parent	1,763	2,461	5,327	5,000	4,500	5,500	5,000	5,500	4,900
% y-y	-	39.6	116.5	-6.1	-15.8	10.0	11.1	0.0	-8.0
Margin (%)	1.0	1.4	3.0	2.7	2.4	2.9	2.6	2.9	2.6
DPS (¥)	15	20	30	20	18	22	18	22	20
H1-end (¥)	7.5	7.5	9	10	9	11	9	11	10
FY-end (¥)	7.5	12.5	21	10	9	11	9	11	10
Consolidated balance sheet									
Cash & equivalents	27,508	29,267	33,500	40,900	36,900	44,700	42,300	49,600	
Accounts receivable	78,100	77,388	75,513	78,000	78,000	79,000	79,000	79,000	
Inventory assets	2,280	2,947	2,736	3,500	3,500	3,500	3,500	3,500	
Spending on uncompleted projects	1,863	2,471	2,268	3,000	3,000	3,000	3,000	3,000	
PPE/intangible long-term assets	10,314	9,639	9,248	8,800	8,700	9,000	8,300	9,100	
Other assets	51,979	57,141	48,426	53,000	59,500	53,000	59,500	53,000	
Total assets	170,181	176,382	169,423	184,200	186,600	189,200	192,600	194,200	
Accounts payable	57,888	56,137	51,460	59,000	59,000	60,000	61,000	61,000	
Advances on uncompleted projects	5,489	2,636	3,140	3,000	3,000	3,000	3,000	3,000	
Interest-bearing debt	7,011	6,836	6,637	7,000	7,000	7,000	7,000	7,000	
Other liabilities	24,874	25,903	23,627	27,800	26,300	27,600	26,400	27,500	
Shareholders' equity	74,891	84,805	84,436	87,400	91,300	91,600	95,200	95,700	
Minority interests	28	65	123	0	0	0	0	0	
Total liabilities and net assets	170,181	176,382	169,423	184,200	186,600	189,200	192,600	194,200	
Turnover period (months)									
Cash & equivalents	1.9	2.0	2.2	2.6	2.3	2.8	2.6	3.1	
Accounts receivable	5.5	5.2	5.1	5.0	4.9	5.0	4.9	5.0	
Inventory assets	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	
Accounts payable	4.1	3.8	3.5	3.8	3.7	3.8	3.8	3.8	

Source: Company data, Nomura estimates

Fig. 4: Sanki Engineering [1961]: consolidated financial data (2)

				(¥mn, except where noted)				
Consolidated cash flow	14/3	15/3	16/3	New 17/3E	Old 17/3E	New 18/3E	Old 18/3E	New 19/3E
Profits attributable to owners of parent	1,763	2,461	5,327	5,000	4,500	5,500	5,000	5,500
Depreciation	740	723	723	700	700	800	700	900
Change in working capital	-8,794	-4,198	-2,021	4,100	-100	0	1,000	1,000
Other	-3,112	875	1,191	-500	100	100	100	100
Operating cash flow	-9,403	-139	5,220	9,300	5,200	6,100	6,800	7,300
Acquisition or sale of PPE	-262	-55	-45	-300	-300	-1,000	-300	-1,000
Other	-3,244	3,495	5,565	0	0	0	0	0
Investment cash flow	-3,506	3,440	5,520	-300	-300	-1,000	-300	-1,000
Change in borrowings	-663	-1,144	-340	400	400	0	0	0
Dividend payments	-1,013	-968	-1,366	-2,000	-1,900	-1,300	-1,100	-1,400
Other	-2,476	-789	-120	0	0	0	0	0
Financial cash flow	-4,152	-2,901	-1,826	-1,600	-1,500	-1,300	-1,100	-1,400
Consolidated indicators								
Free cash flow	-12,909	3,301	10,740	9,000	4,900	5,100	6,500	6,300
EBITDA	3,558	3,674	7,232	7,200	7,200	7,800	7,700	7,900
Shares out (FY-end, mn)	70	67	67	67	67	67	67	67
Treasury stock (FY-end, mn)	4	3	3	3	3	3	3	3
EPS (¥)	26.5	38.3	83.8	78.7	70.8	86.5	78.7	86.5
CFPS (¥)	37.1	49.3	95.2	89.7	81.8	99.1	89.7	100.7
BPS (¥)	1,142.7	1,334.7	1,328.6	1,375.1	1,436.6	1,441.2	1,497.9	1,505.7
ROE (%)	2.3	3.0	6.3	5.8	5.1	6.1	5.4	5.9
ROA (%)	1.0	1.4	3.1	2.8	2.5	2.9	2.6	2.9
Total asset turnover ratio (months)	11.9	11.8	11.4	11.8	11.8	12.0	12.0	12.2
D/E ratio (x)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Shareholders' equity to total assets (%)	44.0	48.1	49.8	47.4	48.9	48.4	49.4	49.3

Source: Company data, Nomura estimates

Appendix A-1

Analyst Certification

I, Kentaro Maekawa, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Sanki Engineering	1961 JP	JPY 804	26-Aug-2016	Neutral	N/A	A6,A11

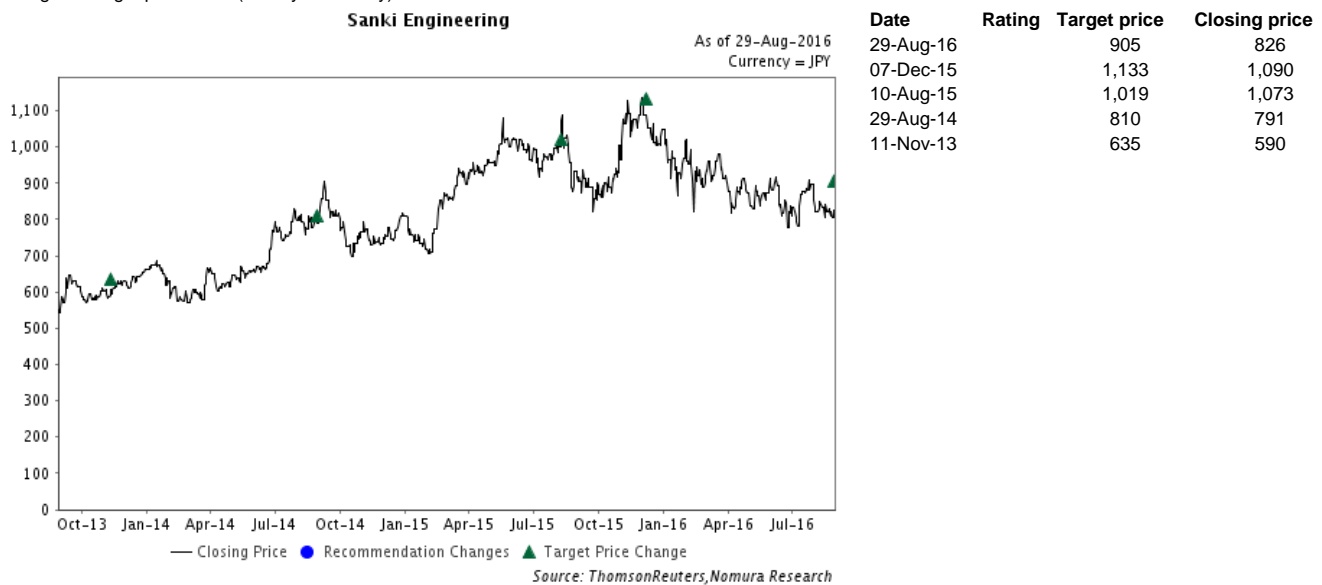
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Sanki Engineering (1961 JP)

JPY 804 (26-Aug-2016) Neutral (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We obtain our target price of ¥905 by applying a P/E of 11-12x to our 17/3 EPS forecast of ¥78.7. We use a target P/E lower than that for the Russell/Nomura Large Cap Index (ex financials) of 16x, because we forecast annualized operating profit growth of 2% through 19/3, lower than average projected growth of 5% for Russell/Nomura Large Cap Index (ex financials) companies, and we reflect risk of suspension for antitrust law violation.

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan prior to 21 October 2013

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When Japanese government bonds (JGBs) for individual investors are purchased via public offerings, only the purchase price shall be paid, with no sales commission charged. As a rule, JGBs for individual investors may not be sold in the first 12 months after issuance. When JGBs for individual investors are sold before maturity, an amount calculated via the following formula will be subtracted from the par value of the bond plus accrued interest: (1) for 10-year variable rate bonds, an amount equal to the two preceding coupon payments (before tax) x 0.79685 will be used, (2) for 5-year and 3-year fixed rate bonds, an amount equal to the two preceding coupon payments (before tax) x 0.79685 will be used. When inflation-indexed JGBs are purchased via public offerings, secondary distributions (uridashi deals), or other OTC transactions with Nomura Securities, only the purchase price shall be paid, with no sales commission charged. Inflation-indexed JGBs carry the risk of losses, as prices fluctuate in line with changes in market interest rates and fluctuations in the nationwide consumer price index. The notional principal of inflation-indexed JGBs changes in line with the rate of change in nationwide CPI inflation from the time of its issuance. The amount of the coupon payment is calculated by multiplying the coupon rate by the notional principal at the time of payment. The maturity value is the amount of the notional principal when the issue becomes due. For J17 and subsequent issues, the maturity value shall not undercut the face amount. Purchases of investment trusts (and sales of some investment trusts) are subject to a purchase or sales fee of up to 5.4% of the transaction amount. Also, a direct cost that may be incurred when selling investment trusts is a fee of up to 2.0% of the unit price at the time of redemption. Indirect costs that may be incurred during the course of holding investment trusts include, for domestic investment trusts, an asset management fee (trust fee) of up to 5.4% (annualized basis) of the net assets in trust, as well as fees based on investment performance. Other indirect costs may also be incurred. For foreign investment trusts, indirect fees may be incurred during the course of holding such as investment company compensation.

Investment trusts invest mainly in securities such as Japanese and foreign equities and bonds, whose prices fluctuate. Investment trust unit prices fluctuate owing to price fluctuations in the underlying assets and to foreign exchange rate fluctuations. As such, investment trusts carry the risk of losses. Fees and risks vary by investment trust. Maximum applicable fees are subject to change; please thoroughly read the written materials provided, such as prospectuses or documents delivered before making a contract.

In interest rate swap transactions and USD/JPY basis swap transactions ("interest rate swap transactions, etc."), only the agreed transaction payments shall be made on the settlement dates. Some interest rate swap transactions, etc. may require pledging of margin collateral. In some of these cases, transaction payments may exceed the amount of collateral. There shall be no advance notification of required collateral value or collateral ratios as they vary depending on the transaction. Interest rate swap transactions, etc. carry the risk of losses owing to fluctuations in market prices in the interest rate, currency and other markets, as well as reference indices. Losses incurred as such may exceed the value of margin collateral, in which case margin calls may be triggered. In the event that both parties agree to enter a replacement (or termination) transaction, the interest rates received (paid) under the new arrangement may differ from those in the original arrangement, even if terms other than the interest rates are identical to those in the original transaction. Risks vary by transaction. Please thoroughly read the written materials provided, such as documents delivered before making a contract and disclosure statements.

In OTC transactions of credit default swaps (CDS), no sales commission will be charged. When entering into CDS transactions, the protection buyer will be required to pledge or entrust an agreed amount of margin collateral. In some of these cases, the transaction payments may exceed the amount of margin collateral. There shall be no advance notification of required collateral value or collateral ratios as they vary depending on the financial position of the protection buyer. CDS transactions carry the risk of losses owing to changes in the credit position of some or all of the referenced entities, and/or fluctuations of the interest rate market. The amount the protection buyer receives in the event that the CDS is triggered by a credit event may undercut the total amount of premiums that he/she has paid in the course of the transaction. Similarly, the amount the protection seller pays in the event of a credit event may exceed the total amount of premiums that he/she has received in the transaction. All other conditions being equal, the amount of premiums that the protection buyer pays and that received by the protection seller shall differ. In principle, CDS transactions will be limited to financial instruments business operators and qualified institutional investors. No account fee will be charged for marketable securities or monies deposited. Transfers of equities to another securities company via the Japan Securities Depository Center are subject to a transfer fee of up to ¥10,800 per issue transferred depending on volume.

Nomura Securities Co., Ltd.

Financial instruments firm registered with the Kanto Local Finance Bureau (registration No. 142)

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