

September orders up 13%, Apr-Sep orders up 4% Large mixed-use development begun in Vietnam

Investment stance: we lower target price by 7%, but reiterate Buy rating

Daiwa House Industry released monthly order receipt data for September on 13 October. Orders rose 13% y-y as those for condominiums fell 21% y-y, and those for rental housing fell 5%, but orders for single-family houses, including houses in subdivisions, rose 3%, and those for commercial buildings rose 24%. Orders for rental housing rose 2% y-y if the effect of orders for large scale properties (¥2bn and higher) received the same month a year earlier are excluded, which we view as solid. Apr-Sep orders were up 4% y-y, 3% if the effect of sales of development properties for logistics facilities and commercial buildings is excluded. We forecast orders will grow 2% y-y in 17/3, in line with the company's forecast, and data thus far has more or less trended in line with our forecast. We thus make no change to our earnings forecasts. Share price performance has been weak, including for rival companies, on concerns that vacancy rates will deteriorate as the rental housing construction market overheats. We think the concern is small that vacancy rates for rental housing will deteriorate at major housing companies, including Daiwa House Industry, but given that housing-related companies under our coverage are trading at only 13x our 17/3 EPS estimates, we lower our target price for Daiwa House Industry to ¥3,730. We think Daiwa House Industry should trade at a P/E that is 15% higher than the average for the companies under our coverage as we expect solid earnings at Daiwa House Industry backed by diversified operations. We see 15x as a fair 17/3 P/E valuation.

Participation in mixed-use development in Hanoi with rental units, offices, retail space

On 13 October, the company released information on the first phase of the Vinata Towers Project, a mixed-use development with rental units, offices, and retail space, that it is carrying out in Hanoi with Taisei [1801]. The company said 256 rental units are scheduled for completion in June 2018 in the first phase. It said a mixed-use development with offices, rental housing, and retail space is scheduled for the second phase. In the three-year medium-term business plan that got underway in 17/3, the company plans ¥700bn in real estate investment, with ¥100bn set aside for overseas investment in projects in the US, ASEAN nations, and other countries. Vinata Towers appears to be one of these projects.

Global Markets Research

13 October 2016

Rating Remains	Buy
Target Price Reduced from 4,000.0	JPY 3,730.0
Closing price 13 October 2016	JPY 2,630.0
Potential upside	+41.8%

Anchor themes

The longer-term outlook for the Japanese housing market is not bright, and we look for developers to diversify into real estate operations and overseas markets. We see Daiwa House Industry at the vanguard of diversification moves.

Catalyst

Potential catalysts include monthly housing start data and monthly order data. We also focus on the regular flow of property transactions at Daiwa House Industry. The company plans to announce Q2 results on 9 November.

Research analysts

Japan housing & real estate

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Cons	16/3		17/3E		18/3E		19/3E	
	Actual	Old	New	Co's	Old	New	Old	New
Currency: JPY								
Sales (bn)	3,192.9	3,410.0	3,410.0	3,420.0	3,530.0	3,530.0	3,660.0	3,660.0
Ope profits (bn)	243.1	255.0	255.0	255.0	265.0	265.0	270.0	270.0
EPS	156.4	248.6	248.6	249.0	256.1	256.1	260.6	260.6
P/E (x)	16.8	10.6	10.6	N/A	10.3	10.3	10.1	10.1
EV/EBITDA (x)	6.9	7.0	7.0	N/A	6.9	6.9	6.7	6.7
P/B (x)	1.5	1.4	1.4	N/A	1.2	1.2	1.1	1.1
Dividend yield (%)	3.0	3.0	3.0	N/A	3.0	3.0	3.0	3.0

Source: Company data, Nomura estimates

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

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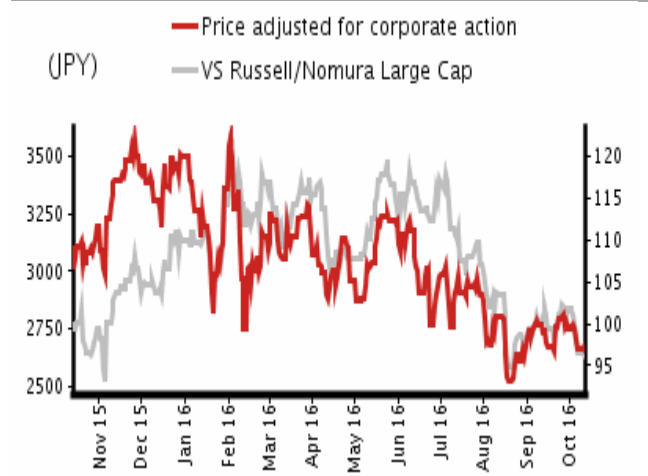
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Daiwa House Industry

Rating

Stock	Buy
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Relative performance chart



Source: ThomsonReuters, Nomura research

Performance

(%)	1M	3M	12M
Absolute	-3.9	-10.3	-15.1
Relative to Russell/Nomura Large Cap	-4.9	-13.5	-3.7

Stock price data

Current stock price (JPY)	2,630.0
Market capitalization (JPY bn)	1,752.2
52-week low stock price (JPY)	2,500.5
52-week high stock price (JPY)	3,654.0
Shares out (mn)	666.2

Source: ThomsonReuters, Nomura research

Valuation and ratio analysis

(JPY)	16/3	17/3E	18/3E	19/3E
EPS	156.4	248.6	256.1	260.6
BPS or NAV per share	1,763.0	1,931.5	2,107.6	2,288.3
DPS	80.0	80.0	80.0	80.0
ROE (%)	9.1	13.5	12.7	11.9

Income statement

(JPY bn)	16/3	17/3E	18/3E	19/3E
Sales	3,192.9	3,410.0	3,530.0	3,660.0
Operating profits	243.1	255.0	265.0	270.0
EBITDA	302.9	320.0	333.0	341.0
Interest & dividend income	7.0	7.0	7.0	7.0
Interest expense	5.0	5.0	5.0	5.0
Recurring profits	233.6	250.0	260.0	265.0
Pretax profits	156.2	245.0	255.0	260.0
Minority interest	1.1	1.0	1.0	1.0
Profits attributable to owners of parent	103.6	165.0	170.0	173.0
(Equity in net income of affiliates)	-0.6	0.0	0.0	0.0

Balance sheet

(JPY bn)	16/3	17/3E	18/3E	19/3E
Current assets	1,329	1,471	1,423	1,442
Operating receivables	282	301	312	323
Inventories	603	700	680	680
Long-term assets	1,929	2,047	2,222	2,334
Total assets	3,258	3,518	3,645	3,776
Operating payables (Current)	368	334	344	355
Interest-bearing debt	516	699	699	699
Total liabilities	2,076	2,224	2,234	2,245
Net assets	1,182	1,294	1,411	1,531
Shareholders' equity	1,170	1,282	1,399	1,519

Cash flow statement

(JPY bn)	16/3	17/3E	18/3E	19/3E
Operating cash flow	278	75	254	240
Profits attributable to owners of parent	104	165	170	173
Depreciation	57	62	65	68
Change in working capital	-15	-150	19	-1
Investment cash flow	-203	-270	-330	-300
Capex	-188	-270	-330	-300
Free cash flow	76	-195	-76	-60
Financial cash flow	-130	129	-53	-53
Change in interest-bearing debt	-78	183	0	0
Dividend payments	-46	-53	-53	-53
Change in cash & equivalents	-46	24	-40	6

Source: Company data, Nomura estimates

Appendix A-1

Analyst Certification

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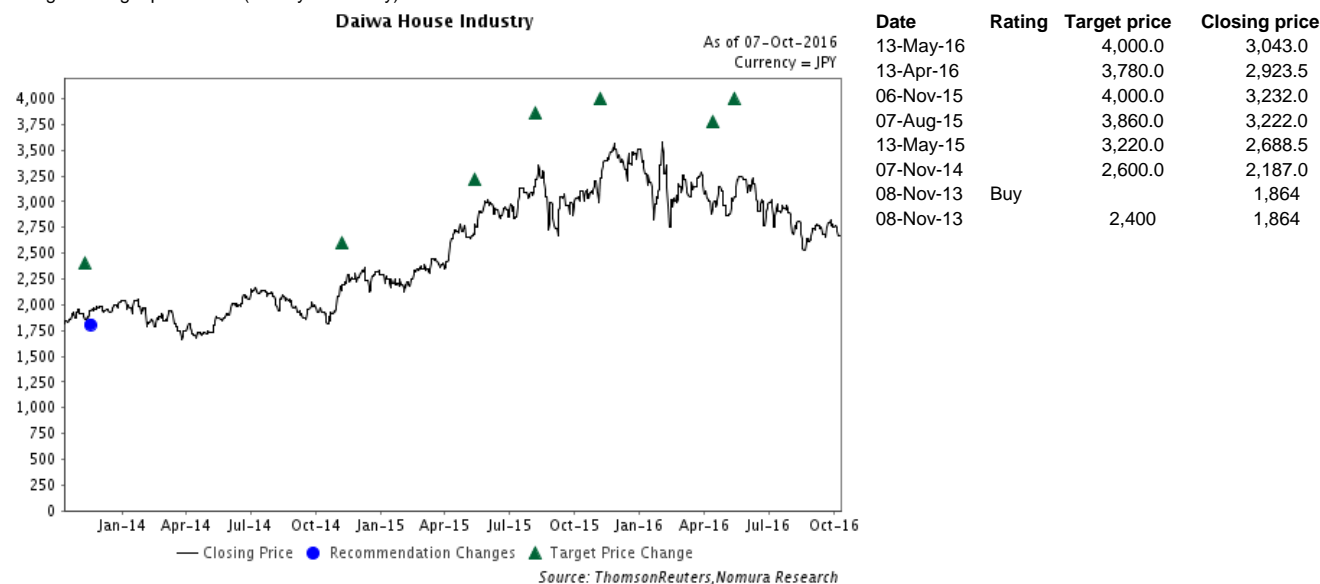
Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Daiwa House Industry	1925 JP	JPY 2,630.0	13-Oct-2016	Buy	N/A	A4,A5,A6,A7,A11,A24,A25

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Daiwa House Industry (1925 JP)

JPY 2,630.0 (13-Oct-2016) Buy (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 calculate our target price based on P/E in view of the stability of the business of developing properties for sale to funds and solid earnings from the single-family house, rental housing, and commercial facility construction businesses. We obtain our target price of ¥3,730 by multiplying our 17/3 EPS forecast of ¥248.6 by a target P/E of 15x. This represents a roughly 15% premium versus the sector average of 13x, reflecting: (1) consistently strong orders, primarily for commercial and logistics facilities; (2) the acquisition of Fujita, which should help it to meet rising construction demand; and (3) the prospect of strong development work for real estate funds.

Risks that may impede the achievement of the target price Over the longer term, we see the need to consider price volatility risk in the housing market, which could see structural decline, and in real estate-related operations, which has grown as a diversified business. In the company's fifth three-year business plan, which started in 17/3, the company plans to invest ¥700bn in real estate, including stepped up investment in overseas real estate, thus exposing the company to the risk of volatility in real estate markets in the US and other locations overseas.

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As at 30 September 2016.

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Margin transactions are subject to a sales commission of up to 1.404% of the transaction amount (or a commission of ¥2,808 for transactions of ¥200,000 or less), as well as management fees and rights handling fees. In addition, long margin transactions are subject to interest on the purchase amount, while short margin transactions are subject to fees for the lending of the shares borrowed. A margin equal to at least 30% of the transaction amount and at least ¥300,000 is required. With margin transactions, an amount up to roughly 3.3x the margin may be traded. Margin transactions therefore carry the risk of losses in excess of the margin owing to share price fluctuations. For details, please thoroughly read the written materials provided, such as listed securities documents or documents delivered before making a contract.

Transactions involving convertible bonds are subject to a sales commission of up to 1.08% of the transaction amount (or a commission of ¥4,320 if this would be less than ¥4,320). When convertible bonds are purchased via OTC transactions (including offerings), only the purchase price shall be paid, with no sales commission charged. However, Nomura Securities may charge a separate fee for OTC transactions, as agreed with the customer. Convertible bonds carry the risk of losses owing to factors such as interest rate fluctuations and price fluctuations in the underlying stock. In addition, convertible bonds denominated in foreign currencies also carry the risk of losses owing to factors such as foreign exchange rate fluctuations.

When bonds are purchased via public offerings, secondary distributions, or other OTC transactions with Nomura Securities, only the purchase price shall be paid, with no sales commission charged. Bonds carry the risk of losses, as prices fluctuate in line with changes in market interest rates. Bond prices may also fall below the invested principal as a result of such factors as changes in the management and financial circumstances of the issuer, or changes in third-party valuations of the bond in question. In addition, foreign currency-denominated bonds also carry the risk of losses owing to factors such as foreign exchange rate fluctuations.

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.

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