

Equities

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Eastern Japan earthquake: Precision/SPE equipment sector

Complete picture unclear, but direct damage looks limited

■ Industry Overview

Masahiro Shibano

+81-3-6270-4784

masahiro.shibano@citi.com

- **Detailed damage assessments will take time** — As quake-damaged logistics and power lifelines have yet to be fully restored, it is hard for companies to make detailed assessments of the effects on their facilities and forecast how long operations might have to be suspended. While the direct damage discussed here looks limited, taking into account the knock-on effects, it will probably take some time to fully grasp the impact.
- **Companies with production bases in Tohoku** — Canon produces interchangeable lenses in Utsunomiya, IJP parts in Fukushima, and LBP cartridges in Aomori; Ricoh makes chemical toner in Miyagi; Nikon produces liquid crystal lithography equipment and DSLRs in Miyagi and semiconductor lithography equipment and interchangeable lenses in Tochigi; and Tokyo Electron makes etchers in Miyagi. We understand there may be direct damage to certain structures and facilities. Hoya, Konica Minolta, Fujifilm, and Seiko Epson do not have major basis in the areas hardest hit, so the impact will probably be less.
- **Indirect effects must be considered as well** — For production bases in the Tohoku region, full recovery of gas and power utilities could take a month or more. It will also take time to restore the logistics infrastructure of fragmented rail lines, roads, and harbors, as well as disaster-struck workplaces, and companies may need to secure alternative production sites and restructure supply chains. Even in the Kanto and Koshinetsu regions that were not hit as hard by the earthquake directly, rolling blackouts may make it hard to get operations at production bases back to normal.
- **Trends to watch** — If power outages lead to a slowdown in economic activity in the Kanto region as well as the earthquake-damaged Tohoku region, it could lead to concerns with regard to earnings at companies that are highly dependent on the domestic market (office equipment makers). Furthermore, in the area of lithography equipment, where high levels of precision are required, even if production equipment itself is not damaged, the effects of the shaking it has received will require inspections and adjustments, and we cannot rule out potential delays in shipments as a result. As unit prices for lithography equipment are high, the impact is likely to be greater than for office equipment and cameras.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Impact on companies in our coverage

The comments below only concern the direct impact of the earthquake

Canon: Operations at plants and research facilities located north of the head office in Tokyo's Ota-ward were suspended as of the 14th. This includes the Utsunomiya (interchangeable lenses), Fukushima (ink jet printer parts), and Aomori (laser printer consumables) plants. We understand Utsunomiya and Fukushima have been damaged although not seriously. Canon is already considering production alternatives. Digital camera bases are concentrated in Kyushu. Oita, Nagasaki, and other plants are operating normally and overseas shipments are not affected.

Ricoh: Details of damage to a chemical toner plant in Miyagi prefecture are unclear but it does not appear to be serious. Toner can also be made at Numadu and we do not expect supply shortages. However, the domestic copier business, which accounts for almost 20% of consolidated sales, is in the middle of fiscal year-end sales negotiations and we cannot rule out the earthquake affecting results.

Nikon: Production has been halted at the following bases due to damage to buildings and equipment: Miyagi (LCD lithographic equipment, professional DSLRs), Tochigi (interchangeable lenses, semiconductor lithographic equipment), Kumagaya, Saitama (semiconductor lithographic equipment, S620, etc). Lithographic equipment must meet exacting standards, and even if facilities have not suffered real damage we believe inspections and other follow-up work could take time and that the effect this has on FY3/11 earnings should be monitored closely. Shipment delays to FY3/12 would reduce sales versus plan: by around ¥5bn for each semiconductor lithographic machine and ¥1.5bn–¥2bn for each LCD lithographic machine. Sales to customers in Korea, Taiwan, and China are booked on a shipment basis, and if machines scheduled to be shipped in the next two weeks are delayed this would be a negative for FY3/11 earnings versus plan.

Fujifilm: Principal production bases are in Shizuoka, Kanagawa, and Kumamoto and direct damage is likely to be limited. Also, we understand that no major suppliers have bases in the Tohoku region. However, like Ricoh, the earthquake could affect year-end sales negotiations at Fuji Xerox's domestic business (consolidated sales weighting of c25%).

Konica Minolta: The direct damage is limited. The company has chemical toner production bases in Yamanashi and Nagano prefectures and we understand they will be affected by forecast power cuts to some extent.

Tokyo Electron: The Miyagi plant of production subsidiary Tokyo Electron AT (Matsushima; etchers, etc) is expected to be closed for at least three weeks and Tokyo Electron Tohoku's Oshu plant (heat treatment coating equipment) for at least two weeks (if utility supplies are restored). Etchers are also made in Yamanashi and that bases will be used to cover shortages while the Miyagi plant is down.

Hoya: The direct damage is limited. In Tohoku, production at the Miyagi plant (endoscopes) has been halted because of power cuts. The contact lens retail business (Eye City) is shortening its operating hours, even outside the Tohoku region, and we expect this to have some impact on results. The Akishima plant in Tokyo (optical glass) is likely to be affected by rolling blackouts. Mainstay HDD (overseas) and mask (Hachioji, Kumamoto) businesses do not appear to have been affected much.

Seiko Epson: The company has four production bases in Tohoku but none of them are principal facilities so the impact of the earthquake will basically be limited. Facilities in Nagano prefecture are operating normally.

Appendix A-1

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