

Precision equipment and SPE sector

January–March results preview

■ Industry Overview

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- **Investment opinion** — We maintain our moderately bullish stance on the precision equipment and SPE sector, as while the yen has weakened and conditions are good, sector stocks have been distinct laggards. Our top pick is Ricoh, where restructuring has been progressing and visibility on FY3/14 earnings is good, yet the shares have been a little soft recently. We also like Fujifilm, on improving sentiment and low valuations. We recommend Canon, a marked laggard. We think Konica Minolta, Hoya, Seiko Epson, Nikon, and Tokyo Electron should be relatively low in any order of investor preference.
- **January–March** — Yen weakness will boost profit versus plan to a greater or lesser extent at all firms. Without forex, fundamentals are at best in line with plan. We expect ex-forex plan undershoots to be sizeable at Konica Minolta and Hoya, although we see their profit beating plan on yen weakness. We understand earnings have been rather weak at Nikon, Canon, Tamron, and Fujifilm, on digicam-related weakness. We expect the others—Ricoh, Seiko Epson, Brother, Tokyo Electron, Olympus, and Dainippon Screen—to be mostly inline.
- **End-demand trends** — In office-related areas, we have seen no major changes in demand trends and expect results to be in line with plan, but we get the impression that digital cameras were weak overall. In TAC film for LCDs, we expect both Fujifilm and Konica Minolta to be in line with plans, which anticipate QoQ declines. We see 2.5" HDD glass substrate conditions as tough, with results falling below conservative plans. January–March SPE orders are set to be in line with prior expectations for QoQ declines. By region, across all businesses we see the Americas as relatively firm and Asia, including China, and Europe as weak.
- **FY3/14 company plans** — We expect FY3/14 initial plans for companies with March year-ends to basically call for profit growth, against a backdrop of yen weakness. We forecast high profit growth rates for Ricoh (restructuring benefits) and Olympus and Fujifilm (improvement in unprofitable businesses). We foresee conservative plans, contrary to market expectations, at Nikon, Brother, and Konica Minolta. We do not expect share price dials to move at Seiko Epson, which announced its plan in the medium-term plan it unveiled in March, and at Hoya, as we do not expect it to announce an initial plan. For companies with December year-ends, we see Canon lifting its plan on changes in forex assumptions and Tamron maintaining its plan for now.
- **Shareholder return policies** — We have hopes of share buybacks in FY3/14 from Canon, Fujifilm, and Ricoh. We think dividend hikes in FY3/14 dividend forecasts are likely at Ricoh, Fujifilm, and Seiko Epson. We see the chances of a dividend cut as high at Tokyo Electron, unless it changes its shareholder return policies. We expect Dainippon Screen to restore its dividend after forgoing one in FY3/13.
- **Stocks low in the preference order** — Stocks we think are low in investors' order of preference are 1) Seiko Epson, where near-term share price drivers look to be exhausted, as it has already announced its FY3/14 plan, 2) Olympus, where we feel hopes of digicam restructuring are overdone, 3) Nikon, where we think the initial plan will fall short of expectations, 4) Konica Minolta, which we think is likely to miss for FY3/13 and announce a conservative FY3/14 plan, and 5) Hoya, which is the only firm we expect to call for lower FY3/14 earnings (although we do expect it to beat its FY3/13 plan).

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

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Figure 1. January-March preview for the companies we cover, share price implications

Code	Company	Current conditions
4901	Fujifilm	Given circumstances in January-March we think company plan is within range. While we see slowness in reducing digital camera losses as a negative, it appears that TAC film and medical products are in line with plan. We also think the likelihood that gains on the sale of assets and weak yen benefits will be larger than had been expected could provide downside support. As the final month of the quarter (March) tends to make a greater contribution to earnings than is true in other quarters, we cannot rule out the possibility of an undershoot, but we think the firm will guide for profit growth in FY3/14. We get the impression that expectations for Fujifilm in the market remain low, but we think the shares look undervalued and expect profit growth in FY3/14. We anticipate good news from core businesses (medical products, industrial equipment and materials) and/or share buybacks in the new fiscal year.
4902	Konica Minolta	We look for sales to fall slightly below plan. While OP looks set to undershoot as well, we think YoY growth is likely (FY3/12 OP was ¥40.3bn). In business equipment color MFPs appear to be doing well in general (including in Europe), but productivity improvements at Chinese factories are slow in coming. In industrial materials and equipment products appear to be in line with plan, but all are softer QoQ. In FY3/14 we think the company will initially guide for 20%-30% YoY OP growth (to ¥50bn+, with EPS at more than ¥50 meaning a PER of just below 13x at the current share price), and this looks low relative to where the shares currently are. If Konica Minolta announces structural reform via ending the pure holding company system (end-March) as well as measures to improve unprofitable businesses and productivity in business equipment, the market could react positively.
6448	Brother	Earnings appear to be more or less in line with plan, but March orders from IT-related customers in industrial equipment could produce a small overshoot. The newly consolidated subsidiary Nissei revised down on March 25 (cutting OP by ¥0.6bn), but this will not impact Brother's plan. We understand commercial and consumer sewing machines are in line with plan, as is the N&C business (karaoke), while business equipment is more or less in line with expectations (strong in the US, soft in Europe and Asia). In FY3/14 we think the firm could set conservative forecasts initially, as despite a strong boost from yen weakness there could be a rise in depreciation and capex, but this is not unexpected.
6724	Seiko Epson	There is little sense that the external environment improved in January-March, and we understand that IJP and projector volume is a little behind plan. However, we also understand that business systems (POS, SIDM) and device-related products are firm. The yen is weaker than the company had expected, which could provide downside support, and we think full-year OP is likely to be in line with the company forecast of ¥18bn. For FY3/14 we think forecasts will basically be in line with the targets in the medium-term plan announced in March (OP of ¥30bn, assuming ¥85/\$ and ¥115/€). We do not expect any new share price catalysts in the near term.
7731	Nikon	We anticipate a small undershoot in January-March. We understand that the precision business is currently in line with expectations (although there is still a risk of a sales miss depending on when inspections end or shipments occur). At the same time, it appears the imaging business is somewhat softer than the company had expected in price terms. That said, it seems to be moving in line with revised plan (volumes were revised downward earlier), and the finished products inventory is expected to be at a normal level as of end-March. We estimate the weak yen will provide a ¥20bn+ boost in FY3/14 but think it likely that initial FY3/14 forecasts will be set conservatively.
7733	Olympus	We understand January-March earnings are in line with internal targets. The medical segment is firm in Europe, Japan, and the US, but due to relative softness in China and other parts of Asia we look for a small overshoot overall. In the imaging segment (digital cameras) ILCs are firm, but compact digital cameras are struggling and overall we look for a small undershoot. We get the impression that imaging can avoid posting inventory valuation losses. When the firm announces FY3/13 results we also expect FY3/14 forecasts and revisions to the medium-term vision. We think structural reform for the imaging business will be based on an assumption of keeping sales at current levels (that is, we do not expect dramatic job cuts or a complete withdrawal from compact digital cameras).
7735	Dainippon Screen	Orders for SPE rose 14% QoQ to ¥29bn in October-December, and in January-March the company looks for flat growth, although it appears orders are running a little ahead of that. Given lead time we think FY3/13 earnings will be more or less in line with downwardly revised company forecasts. In FY3/14 we anticipate a return to profitability thanks to fixed cost cuts (boosting profits by ¥5bn) and improvement in the variable cost rate in the SPE business (5ppt improvement, boosting profits by ¥6.5bn). If orders improve during the latter half of the fiscal year, we could see further upside. No clear catalysts are likely in the near term, but as DNS has been underperforming other SPE firms we think it is a relatively appealing investment.
7740	Tamron	January-March is generally a low period for profits, and inventory adjustments are taking place during FY12/13 H1, so we understand the company has long thought YoY profit growth would be challenging. Earnings appear in line with plan through February, but it seems that high-margin own-brand lenses are somewhat softer than had been budgeted. There appears to be little sense of demand recovery in Europe, the US, and China. As it is early to revise assumptions underlying full-year forecasts, we do not expect changes for now. We believe real improvement in expectations will come in Q2 (April-June).
7741	Hoya	Core businesses appear generally soft in January-March. Blanks and other semiconductor-related products are relatively firm, but we understand HDD products and optical glass are particularly weak (the "life care" business is generally in line with plan, apparently). There is little impact from yen weakness on Hoya's core businesses, but on paper profits could rise above plan (after forex adjustments for foreign currency assets). Hoya's forex assumptions are conservative at ¥80/\$ and ¥100/€, and end-March rates for both the dollar and euro were about ¥10 weaker than at end-December, so we think this will add several billion yen to profits (it is difficult to estimate this accurately, though). At current levels we see little reason to buy the shares. The Hoya COO left the firm in June 2012, and the CFO is expected to leave in June of 2013. We will be interested to see what new management does.
7751	Canon	It does not seem that YoY OP growth has accelerated during Q1 (January-March). Canon has not announced Q1 forecasts. We understand that LBP and copiers are in line with internal targets, while digital cameras are somewhat behind (recovery in shipments to China is slow). However, we estimate the boost to profits from a weaker-than-expected yen at about ¥20bn, so we see no cause for significant concern. When January-March results are announced at end-April, we anticipate upward revisions (albeit small ones) based on revisions to forex estimates.
7752	Ricoh	Overall sales were up slightly YoY in local currencies. We understand sales in the Americas are relatively firm compared with a year ago, while Europe and Japan are flat and Asia is up around 10%. As a result, we think yen-denominated earnings were in line with plan or even above plan. The company continues to put a high priority on profitability. Thanks to QoQ profit growth in January-March stemming from a QoQ decline in structural reform costs, higher benefits from fixed cost cuts, and a rise in sales (helped by the end of the fiscal year) we think the achievement of company forecasts is in sight. We intend to keep an eye on what new president Miura says about management policy is (including structural reform) at the end-April results briefing and late May company briefing.
8035	Tokyo Electron	We continue to think that orders will be in line with the company forecast of c¥80bn in January-March. Based on lead times, we do not think full-year earnings will fall that far from downwardly revised forecasts. In FY3/14 we think the negative impact of consolidating Oerlikon Solar (¥5bn-¥10bn) can be offset by fixed cost cuts (boosting profits by ¥10bn), increased sales of LCD production equipment (boosting profits by c¥5bn), and increased revenue and profits from SPE. However, orders could well enter a slow period in April-June.

Source: Citi Research.

Figure 2. Summary of our January-March 2013 previews

	Rating	Target Price (¥)	Share Price Apr-13 (¥)	Stock Performance(%)			Operating Profit (¥bn)								FY13 E PER(X)	FY13 E PBR(X)
				CY 2012 Annual	CY 2013 YTD	Nov-14 to date	Oct-Dec '12 Actual	Jan-Mar '13 Outlook	Jan-Mar '13 Guidance	Jan-Mar '12 Actual	FY12 Citi Estimate	FY12 Guidance	FY12 Consensus	FY13 Consensus		
4901 Fujifilm	Buy	2,100	1,778	-5%	3%	39%	23.1	40.6	41.2	27.4	106.0	110.0	107.9	137.1	11.1	0.4
4902 Konica Minolta	Neutral	750	640	7%	4%	25%	6.8	14.9	20.9	17.1	45.0	48.0	46.4	57.6	10.7	0.7
6448 Brother	Buy	1,100	908	-28%	-1%	34%	6.1	2.2	2.2	0.6	28.0	28.0	28.6	34.0	10.5	1.0
6724 Seiko Epson	Neutral	1,000	840	-32%	21%	94%	25.9	5.2	6.2	3.5	17.0	18.0	18.4	32.6	10.1	0.6
7731 Nikon	Neutral	2,100	2,130	47%	-16%	19%	2.1	7.7	8.8	10.7	50.0	48.0	50.2	83.9	13.1	1.6
7733 Olympus	Neutral	2,200	2,144	72%	38%	76%	6.6	9.4	10.4	9.6	35.0	35.0	35.2	74.3	23.3	8.6
7735 Dainippon Screen	Buy	500	423	11%	-19%	2%	-6.9	3.0	3.5	3.9	-7.5	-7.0	-6.4	5.2	28.6	1.2
7740 Tamron	Buy	2,500	2,010	12%	-17%	-4%	1.2	0.3	NA	0.8	7.4	6.3	7.2	8.6	10.5	1.1
7741 HOYA	Neutral	1,800	1,753	2%	4%	15%	17.6	10.6	9.6	14.1	70.0	69.0	75.0	65.9	14.1	1.7
7751 Canon	Buy	3,900	3,270	-2%	-2%	34%	77.7	92.0	NA	82.7	470.0	410.0	472.8	510.2	12.0	1.4
7752 Ricoh	Buy	1,200	973	35%	7%	52%	13.1	33.5	34.5	18.5	73.0	75.0	73.9	133.4	9.1	0.8
8035 Tokyo Electron	Neutral	4,100	4,140	1%	5%	21%	-6.9	4.9	4.2	17.5	10.2	9.5	9.1	17.2	47.0	1.3

Note: Hoya OP is based on IFRS (pre-tax income from continuing operations, all-business base). Tamron and Canon follow January-December fiscal years, so FY12 and FY13 refer to FY13 and FY14 in the OP columns. FY13 for both PER and PBR. Share prices as of April 3 close.

Source: Company data, IFIS, Citi Research.

Figure 3. Summary of trends in main product categories as of end-April 2013

Product category	Prevailing trends
Office multifunction printers	We feel they are firm overall, with companies broadly moving in line with plans. We do not sense that price competition between Japanese manufacturers themselves is intensifying particularly. We do not have the impression that market conditions are weakening further and lease approval rates are not falling (in business talks for office MFPs, where leases are the norm). Consumables and printout rates remain in positive YoY territory and near term we do not expect paperless offices to materialize.
LBP's	Canon, which effectively supplies more than half of LBP's globally once Hewlett-Packard OEM is included, completed a production correction in September 2012. We see January-March as being in line with plan. We understand Brother has been faring well, especially in the US. Hewlett-Packard has still not turned more aggressive on sales promotions and market pricing conditions appear to be favorable.
Production printers	In the arena of production printers, which are used by commercial printers and at corporate print centers, the slowdown in printer sales volumes continues largely unchanged. Compared to MFPs for offices, production printer prices are high (around ¥10mn even at the low end, with mid-range models costing ¥20mn-¥30mn or more), and we understand there have been cases in which it has been hard to offer credit at the time of the lease.
IJP's	There has been no clear recovery in IJP demand, which is mainly consumer demand. Canon and Seiko Epson have both suggested that January-March was in line with plan. However, Seiko Epson, which had the edge in compact new products for autumn/winter 2012, looks to have had greater product competitiveness in the year-end shopping season, which should mean it was able to avoid price cuts. Future interest centers on Hewlett-Packard's marketing strategy (Office Jet Pro X and consumer products).
ILCs	The market has continued to deteriorate since October-December; we believe January-March will be in line with plan at best. Some say that volumes will be on par with expectations but we understand prices have been weak. By region, Europe and China have been soft. Diffusion rates are still low, so room to grow remains. Near-term, however, we note the possibility that softening proportionate to business sentiment will continue. However, we expect to see clearer intent to stress profit at companies in FY3/14.
Compact digital cameras	There has been no good news recently and the market is in our view likely to contract in 2013, too, especially in developed markets. Lower-ranked manufacturers in particular have narrowed their focus to models in low price brackets, so we forecast that higher-ranked makers (Canon and Nikon) with full lineups will raise their market share in a shrinking market. The focus at lower-ranked makers, who are facing scaled-back operations, is on whether they try to cut fixed costs.
LCD-use TAC films	Versus October-December, when panel makers' operating rates improved, companies have been forecasting a QoQ correction in January-March. Recently, trends have been moving in line with these plans. Substitute films have become a hot topic, but the adoption of acrylic films has been delayed further and we think PET films will remain small-scale near term. Interest focuses on whether Fujifilm and others can supply competitor products in the near future.
2.5" HDD glass substrates	We expect Hoya, which has a market share of c80%, to see a 15% drop versus October-December, softer than expected. We expect Konica Minolta, which we estimate has a market share of 20%, to see a 50% drop, with no signs of a recovery yet. It looks as though Konica Minolta will now have to articulate earnings improvement measures, including fixed cost cuts.
Semiconductor/LCD production equipment	Versus October-December (orders up 36% QoQ to ¥91.3bn), when Tokyo Electron had several orders brought forward, we think January-March orders are likely to contract to around ¥80bn or so. In contrast, we expect Dainippon Screen orders to rise slightly, to just over ¥30bn, versus October-December, when they were up 14% QoQ to ¥29.0bn, with no particular change in direction. We feel April-June orders are likely to hit a temporary fallow patch.

Source: Company data, company discussions, Citi Research.

Figure 4. Results schedule for related stocks (as of April 2)

Code	Company	Earnings announcement	Analyst meeting	Meeting time	Meeting location	Focal points
4901	Fujifilm	April 30	April 30	TBA	Fujifilm headquarters	Will it hike DPS? New products in the medical business and in industrial materials and equipment
4902	Konica Minolta	May 10	May 10	1830-1930	Nomura Conference Plaza Nihonbashi	Forecasts for new fiscal year, how unprofitable businesses are handled
6448	Brother	May 9	May 10	1330-1430	Marunouchi Trust Tower North 3F	Outlook for LBPs and machine tools for EMS firms
6724	Seiko Epson	April 30	April 30	1700-1800	Nomura Conference Plaza Nihonbashi	H1 and H2 breakdown of forecasts for the new fiscal year
6856	Horiba	May 10	May 10	1800-1845	Telephone conference	Whether yen weakness means changes in the external environment
6961	Enplas	April 30	April 30	1600-1700	Kabutocho Heiwa Building	LCD materials, business equipment materials
7613	Siix	May 10	NA	NA	NA	Momentum for digital consumer electronics
7701	Shimadzu	May 10	May 13	1300-1400	Belle Salle Yaesu	China trends, products related to supplemental budget in Japan
7731	Nikon	May 9	May 9	1645-1830	UrbanNet Otemachi Building 21F	Digital camera inventories, new fiscal year plan, revisions to medium-term plan
7733	Olympus	May 15	May 15	TBA	TBA	Digital camera structural reform, revisions to medium-term plan
7735	Dainippon Screen	May 10	May 10	1700-180	Nomura Securities Nihonbashi headquarters	SPE orders, progress in structural reform
7739	Canon Electronics	Apr 24	NA	NA	NA	Trends for business equipment, camera materials
7740	Tamron	April 26	NA	NA	NA	Forecasts for the new fiscal year (ending December)
7741	HOYA	May 8	May 8	1530-1630	Belle Salle Yaesu	Eyeglass lens business, AvanStrate earnings
7751	Canon	April 24	April 24	1550-1640	TSE Hall	Whether company plans are revised, announcement of share buybacks
7752	Ricoh	April 26	April 26	1800-1900	Otemachi Sankei Plaza	Progress in structural reforms, dividend hikes, management policy under the new president
8035	Tokyo Electron	April 30	April 30	1800-1900	Tokyo Electron headquarters	SPE orders, earnings impact of Oerlikon Solar
8051	Yamazen	May 8	May 29	1330-1430	Otemachi SUNSKY ROOM	Machine tool trends
8060	Canon MJ	April 22	April 23	1000-1130	TSE Hall	Domestic market trends

Source: Company data, company discussions, Citi Research.

Figure 5. Estimating impact of yen weakness on OP: Assuming ¥90/\$ and ¥120/€, yen weakness alone would boost OP by 20%-40%

Ticker	Company name	Latest Forex assumption (yen)		Forex effect on sales by one yen move (annual, ¥bn)		Forex effect on OP by one yen move (annual, ¥bn)		①Upside on Jan-Mar OP (vs CE / ¥bn, %)				②FY13 OP change (vs FY12 / ¥bn, %)				③Effect on FY13 OP (with 5 yen move - vs Consensus/ ¥bn, %)			
								US\$		€EUR		Total (C=A+B)		vs FY12		vs FY12		+5	
		USD		EUR		USD		vs CE		vs CE		C=A+B		vs FY12		vs FY12		+5	
		USD	EUR	USD	EUR	USD	EUR	vs CE	vs CE	vs CE	vs CE	C=A+B	upside	vs FY12	vs FY12	vs FY12	vs FY12	upside	upside
4901	Fujifilm	87	116	5.70	1.80	1.40	0.90	1.8	1.4	3.1	2.8%	10.5	12.0	22.5	20.4%	7.0	4.5	11.5	8.4%
4902	Konica Minolta	85	115	2.90	1.40	0.40	0.80	0.7	1.4	2.1	4.4%	3.0	10.6	13.6	28.4%	2.0	4.0	6.0	10.4%
6724	Seiko Epson	75	100	2.80	1.70	0.20	1.20	0.9	6.6	7.5	41.4%	1.5	16.0	17.5	97.0%	1.0	6.0	7.0	21.9%
7731	Nikon	85	115	5.20	2.00	0.40	1.50	0.7	2.6	3.3	6.9%	3.0	20.0	23.0	47.8%	2.0	7.5	9.5	11.3%
7741	HOYA	80	100	NA	NA	0.30	0.10	0.9	0.6	1.5	NA	2.3	1.3	3.6	NA	1.5	0.5	2.0	NA
7751	Canon	85	115	19.70	8.60	7.70	4.60	13.5	8.1	21.5	5.3%	61.6	64.4	126.0	30.7%	38.5	23.0	61.5	12.0%
7752	Ricoh	85	115	6.50	3.50	1.30	1.50	2.3	2.6	4.9	6.5%	9.8	20.0	29.7	39.6%	6.5	7.5	14.0	10.5%
8035	Tokyo Electron	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
7733	Olympus	90	120	2.50	1.30	0.40	0.60	0.2	0.3	0.5	1.4%	3.0	8.0	11.0	31.4%	2.0	3.0	5.0	6.8%
6448	Brother	83	115	1.50	1.00	0.05	0.70	0.1	1.2	1.3	4.8%	0.4	9.3	9.7	34.6%	0.3	3.5	3.8	11.1%
7740	Tamron	85	115	0.40	0.10	0.06	0.09	0.1	0.2	0.3	4.2%	0.5	1.3	1.7	27.6%	0.3	0.5	0.8	8.7%
7735	Screen	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
7762	Citizen	90	120	1.20	0.12	0.40	0.05	0.2	0.0	0.2	1.9%	3.0	0.7	3.7	30.5%	2.0	0.3	2.3	12.5%

Note 1. "Upside for January-March OP" is the estimated upside to quarterly OP (25% of the full-year impact) based on the difference between the average rates for the quarter (which we estimate at ¥93/\$ and ¥122/€) and the rates assumed by the company in question. The "upside rate" is the impact versus FY12 forecasts.

Note 2. "YoY OP upside for FY13" is the impact on OP via YoY yen weakness, assuming ¥90/\$ and ¥120/€ in FY13 versus the average rates for FY12. The "upside rate" is the impact versus FY12 forecasts.

Note 3. "Impact on FY13 OP" is the impact from a ¥5 weakening against the dollar and euro based on FY13 IFIS consensus forecasts.

Note 4. Forex assumptions in the figure represent assumptions at each company for January-March and beyond. The forex sensitivity of sales and OP is our estimate based on company data and discussions.

Source: Company data, IFIS, Citi Research.

Appendix A-1

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