

Nabtesco (6268)

Sell-off after earnings downgrade provides attractive entry point

- What is new** — Nabtesco's share price slumped 11% in the immediate aftermath of the October 31 downward revision. While we were disappointed with the 16% cut to FY3/14 OP guidance, we continue to see Nabtesco as a geared play to the long-term growth story of industrial robots. We also like its high share in key products, cash-rich balance sheet, and double-digit RoE, and so we maintain our Buy rating. On the reduced guidance, we revise our estimates for this term out and trim our SoTP-based target price to ¥2,500 from ¥2,700.
- Revisions to FY3/14 guidance** — Nabtesco lowered its FY3/14 sales target ¥2.1bn, citing slower than expected demand for speed reducers from European robot makers, weak demand for hydraulic components from Chinese excavator makers, and sluggish demand in Japan for large-sized automatic doors. OP guidance was cut ¥3.5bn given these factors plus depressed demand for high-margin after-service sales from European airlines as well as a worsening product mix for hydraulic components from excavator customers.
- Where are the positives?** — Precision equipment orders in September rose 10% YoY helped by robust demand for speed reducers from domestic robot suppliers. Elsewhere, hydraulic orders in Japan were up 94% and very easy comps lead to +1,000% surge in orders at its subsidiary in Shanghai. Orders for truck-use braking systems were also ahead 24%. In China, sales of braking systems to rolling stock makers in H1 were ahead of target at ¥2.5bn, and the company has made no change to its FY3/14 target of ¥6.0bn. We note headcount has been reduced at the Tsu factory, leading to an increase in productivity and together with lower depreciation expenses, H2 margins in precision equipment should be above 15%.
- Robust financials** — FCF in H1 was ¥7.3bn in the black, helped by a reduction in capex spending by c60% YoY and net cash on the balance sheet stood at ¥20bn, up ¥7bn QoQ. Despite the lowered guidance, the FY3/14 planned dividend is still ¥38/share. We estimate RoE in FY3/14 will be 11%.

- Estimate Change
- Target Price Change

Buy	1
Price (01 Nov 13)	¥2,135
Target price	¥2,500
	from ¥2,700
Expected share price return	17.1%
Expected dividend yield	1.8%
Expected total return	18.9%
Market Cap	¥272,277M
	US\$2,768M

Price Performance (RIC: 6268.T, BB: 6268 JP)



Consol.	Sales		OP			RP		NP		EPS	PE
	¥M	YOY (%)	¥M	YOY (%)	OPM (%)	¥M	YOY (%)	¥M	YOY (%)	¥	X
3/12A	198,527	17.3	22,859	13.1	11.5	24,656	10.2	14,757	10.2	117	18.3
3/13A	179,543	-9.6	15,014	-34.3	8.4	17,890	-27.4	13,271	-10.1	105	20.3
3/14CE	201,000	12.0	22,000	46.5	10.9	25,100	40.3	15,900	19.8	125	17.0
3/14CRE	198,900	10.8	18,500	23.2	9.3	22,100	23.5	13,900	4.7	109	19.6
3/14E	198,300	10.4	22,058	46.9	11.1	25,528	42.7	17,171	29.4	136	15.7
3/14RE	199,013	10.8	18,550	23.6	9.3	21,800	21.9	14,000	5.5	111	19.3
3/15E	217,000	9.4	26,105	18.3	12.0	29,025	13.7	20,068	16.9	159	13.4
3/15RE	216,000	8.5	24,370	31.4	11.3	27,880	27.9	19,168	36.9	152	14.1
3/16E	234,000	7.8	29,905	14.6	12.8	32,565	12.2	22,156	10.4	175	12.2
3/16RE	230,000	6.5	27,415	12.5	11.9	30,985	11.1	21,590	12.6	171	12.5

A: Actuals, E: Citi Research Ests, CE: Co. Ests, RE: Citi Research Revised Ests, CRE: Co. Revised Ests, NA: Not Available, NM: Not Meaningful

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

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6268.T: Fiscal year end 31-Mar						Price: ¥2,135; TP: ¥2,500; Market Cap: ¥272,277m; Recomm: Buy					
Profit & Loss (¥m)	2012	2013	2014E	2015E	2016E	Valuation ratios	2012	2013	2014E	2015E	2016E
Sales revenue	198,527	179,543	199,013	216,000	230,000	PE (x)	18.3	20.3	19.3	14.1	12.5
Cost of sales	-148,184	-134,859	-151,606	-159,230	-168,545	PB (x)	2.7	2.4	2.2	2.0	1.8
Gross profit	50,343	44,684	47,407	56,770	61,455	EV/EBITDA (x)	8.1	10.9	8.9	7.0	5.9
Gross Margin (%)	25.4	24.9	23.8	26.3	26.7	FCF yield (%)	-1.5	-2.3	1.9	4.9	4.6
EBITDA (Adj)	30,126	23,281	28,066	33,963	36,993	Dividend yield (%)	1.6	1.8	1.8	1.9	2.1
EBITDA Margin (Adj) (%)	15.2	13.0	14.1	15.7	16.1	Payout ratio (%)	29	36	34	26	26
Depreciation	-7,267	-8,267	-9,516	-9,593	-9,578	ROE (%)	15.6	12.4	11.8	14.7	14.8
Amortisation	0	0	0	0	0	Cashflow (¥m)					
EBIT (Adj)	22,859	15,014	18,550	24,370	27,415	EBITDA	30,126	23,281	28,066	33,963	36,993
EBIT Margin (Adj) (%)	11.5	8.4	9.3	11.3	11.9	Working capital	-2,380	-4,024	-3,460	-574	-3,730
Net interest	-25	-40	-50	10	70	Other	-22,732	-12,653	-9,550	-10,202	-10,826
Non-op/Except	1,822	2,916	3,300	3,500	3,500	Operating cashflow	5,014	6,604	15,056	23,188	22,438
Recurring profit	24,656	17,890	21,800	27,880	30,985	Capex	-9,023	-12,873	-10,000	-10,000	-10,000
Tax	-8,873	-5,598	-6,300	-7,962	-8,396	Net acq/disposals	0	0	0	0	0
Extraord./Min.Int./Pref.div.	-1,026	979	-1,500	-750	-1,000	Other	-18,441	-820	-1,000	-1,000	-1,000
Reported net profit	14,757	13,271	14,000	19,168	21,590	Investing cashflow	-27,464	-13,693	-11,000	-11,000	-11,000
Net Margin (%)	7.4	7.4	7.0	8.9	9.4	Dividends paid	-4,636	-5,077	-4,844	-5,099	-5,737
Core NPAT	14,757	13,271	14,000	19,168	21,590	Financing cashflow	6,035	-10,090	-5,062	-16,199	-5,737
Per share data						Net change in cash	-16,638	-16,171	-1,006	-4,011	5,702
Reported EPS (¥)	117	105	111	152	171	Free cashflow to s/holders	-4,009	-6,269	5,056	13,188	12,438
Core EPS (¥)	117	105	111	152	171						
EPS* (¥)	117	105	111	152	171						
DPS (¥)	34	38	38	40	45						
CFPS (¥)	40	52	119	183	178						
FCFPS (¥)	-32	-50	40	104	98						
BVPS (¥)	786	905	977	1,089	1,215						
Wtd avg ord shares (m)	126	126	126	126	126						
Wtd avg diluted shares (m)	126	126	126	126	126						
Growth rates											
Sales revenue (%)	17.3	-9.6	10.8	8.5	6.5						
EBIT (Adj) (%)	13.1	-34.3	23.6	31.4	12.5						
Core NPAT (%)	10.2	-10.1	5.5	36.9	12.6						
Core EPS (%)	10.2	-10.1	5.5	36.9	12.6						
Balance Sheet (¥m)											
Cash & cash equiv.	50,503	40,902	45,406	51,621	72,420						
Accounts receivables	47,539	45,131	45,230	48,000	41,818						
Inventory	20,109	20,529	22,113	21,600	20,909						
Net fixed & other tangibles	53,007	56,045	56,459	56,866	57,287						
Goodwill & intangibles	15,838	17,579	19,500	17,500	15,500						
Financial & other assets	21,096	22,870	25,580	25,853	26,077						
Total assets	208,092	203,056	214,288	221,439	234,012						
Accounts payable	34,601	28,026	33,169	36,000	32,857						
Short-term debt	11,412	6,098	15,600	5,000	5,000						
Long-term debt	20,281	20,220	10,500	10,000	10,000						
Provisions & other liab	34,331	27,854	24,965	26,271	26,085						
Total liabilities	100,625	82,198	84,234	77,271	73,942						
Shareholders' equity	99,301	114,343	123,541	137,654	153,556						
Minority interests	8,165	6,514	6,514	6,514	6,514						
Total equity	107,466	120,857	130,055	144,168	160,070						
Net debt	-18,810	-14,584	-19,306	-36,621	-57,420						
Net debt to equity (%)	-17.5	-12.1	-14.8	-25.4	-35.9						

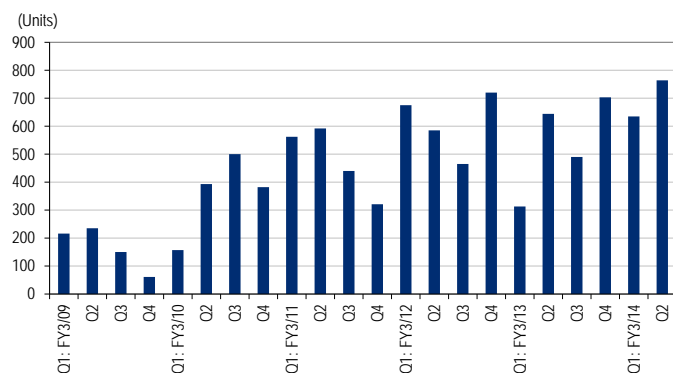
Note: Consolidated data. * EPS: NP/Est Shares OS.

Figure 1. Nabtesco: Sales, OP and operating margin breakdown by segment

(¥mn)	FY3/09	FY3/10	FY3/11	FY3/12	FY3/13	FY3/14CE	FY3/14E	FY3/15E	FY3/16E
Sales	158,168	126,249	169,303	198,527	179,542	198,900	199,013	216,000	230,000
Precision Equipment	28,026	15,278	32,438	44,199	41,578	43,300	43,513	52,000	55,000
Transportation Equipment	46,765	41,888	48,182	48,289	44,262	49,800	49,500	50,000	54,000
Aero/Hydraulics	51,390	41,492	59,106	64,240	45,746	52,400	52,500	59,000	65,000
Industrial Equipment	31,987	27,589	29,575	41,798	47,956	53,400	53,500	55,000	56,000
Operating profit	12,012	7,964	20,212	22,859	15,012	18,500	18,550	24,370	27,415
Precision Equipment	2,506	603	6,466	8,013	5,354	6,300	6,309	8,320	9,350
Transportation Equipment	4,682	3,654	5,915	6,068	4,214	5,200	5,346	5,750	6,480
Aero/Hydraulics	2,614	1,804	5,609	6,130	1,836	3,100	3,150	5,900	6,825
Industrial Equipment	2,209	1,902	2,220	2,646	3,608	3,900	3,745	4,400	4,760
Operating margin	7.6%	6.3%	11.9%	11.5%	8.4%	9.3%	9.3%	11.3%	11.9%
Precision Equipment	8.9%	3.9%	19.9%	18.1%	12.9%	14.5%	14.5%	16.0%	17.0%
Transportation Equipment	10.0%	8.7%	12.3%	12.6%	9.5%	10.4%	10.8%	11.5%	12.0%
Aero/Hydraulics	5.1%	4.3%	9.5%	9.5%	4.0%	5.9%	6.0%	10.0%	10.5%
Industrial Equipment	6.9%	6.9%	7.5%	6.3%	7.5%	7.3%	7.0%	8.0%	8.5%

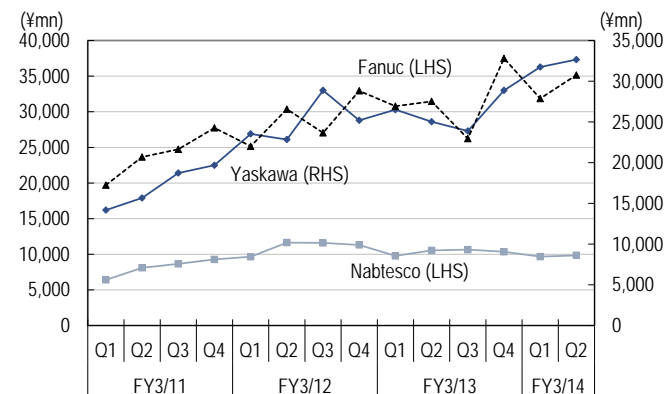
Source: Company data, Citi Research.

Figure 2. Yaskawa China robot orders (units)



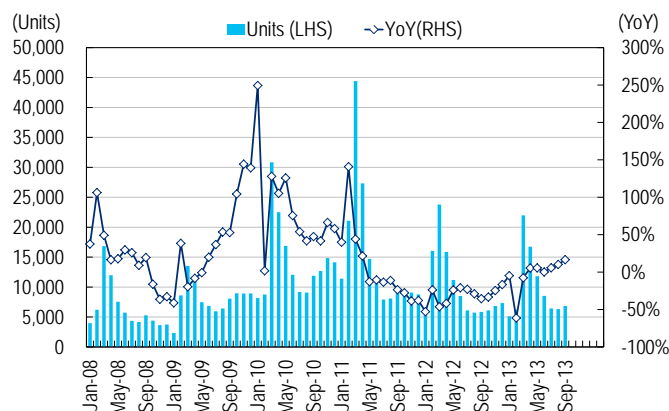
Source: Company data, Citi Research.

Figure 3. Nabtesco precision eq sales vs Yaskawa & Fanuc robot revs



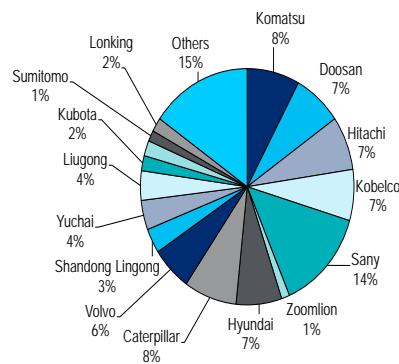
Source: Citi Research.

Figure 4. Excavator demand in China



Source: CCMA, Citi Research.

Figure 5. Market share for excavators in China (Jan-Sep 2013)



Source: CCMA, Citi Research.

Nabtesco

Investment strategy

We rate Nabtesco a Buy with a target price of ¥2,500. Nabtesco provides investors with a way to gain exposure to a number of end markets, such as industrial robots, construction equipment in China, rolling stock, civilian aerospace, public transport safety and 3D printing. As with any conglomerate there is a concern that the whole is worth less than the sum of the parts but what makes Nabtesco stand out, in our view, is its high global share in key products, such as 60% for robot-use precision speed reducers and a 30% share for traveling motors used in excavators. The shares are often seen as a proxy on growth in China and we note that in Q1 FY3/14 sales in China accounted for 12% of total revenue.

Valuation

For what is effectively a mini-conglomerate, we think a sum-of-the-parts (SoTP) approach is the most appropriate way to try to value the shares. We use a range of domestic and overseas companies for each of the four divisions to come up with an estimated equity value. In precision equipment we compare Nabtesco against Fanuc, Harmonic Drive and SHI; in transport equipment our benchmarks include Mitsubishi Electric, Alstom and Wabtec; in Aircraft & Hydraulics our comps include Komatsu, KYB and Parker Hannifin; and in the industrial equipment division we compare the company against Assa Abloy and Stanley Black & Decker. We use a blend of PER, EV/sales, and EV/EBIT to derive our target price of ¥2,500. At this level, based on our earnings forecasts for FY3/15, the shares would trade on a PER of c16.5x and an EV/EBITDA of 10x and 2.2x PBR. In terms of historical averages, over the past eight years (FY3/06-FY3/13) the PER and EV/EBITDA have averaged 20x and 7.3x, respectively, with a PBR of 2.0x. Over the same period, the median PER was 17x with an EV/EBITDA of 6.9x. We estimate each one yen move against the USD and CHF impacts OP by c¥120mn and ¥10mn respectively, and each one yen move against the RMB impacts OP by c¥600mn.

Risks

Downside risks include 1) a slowdown in global economic activity; 2) a further decline in demand for construction equipment in China due to tighter credit conditions, higher interest rates and/or a slow run down of inventory; 3) the failure to win new contracts to supply rolling stock makers in China, possibly due to changes in government policy; and 4) a failure of auto capex to recover in developed economies. If these or other factors manifest themselves to a greater extent than we have anticipated, the share price may fall below our target price.

Appendix A-1

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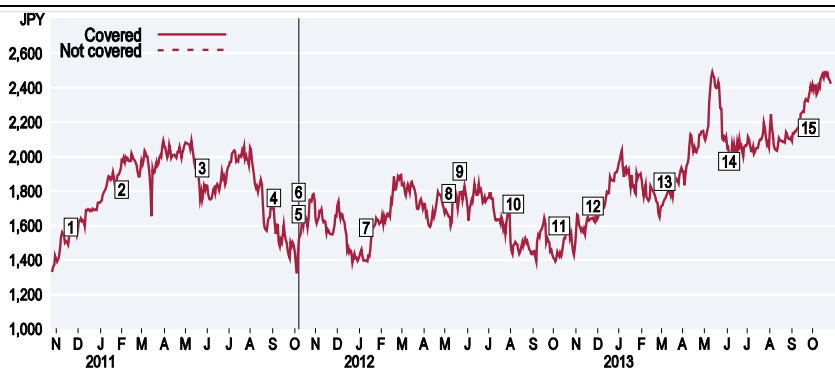
IMPORTANT DISCLOSURES

Nabtesco (6268)

Ratings and Target Price History

Fundamental Research

Analyst: Graeme McDonald



Date	Rating	Target Price	Closing Price
1 22-Nov-10	1M	*1,800	1,588
2 1-Feb-11	1M	*2,300	1,980
3 25-May-11	1M	*2,100	1,750
4 2-Sep-11	1M	*2,000	1,690
5 7-Oct-11	Stock rating system changed		

Date	Rating	Target Price	Closing Price
6 7-Oct-11	*1	2,000	1,518
7 11-Jan-12	1	*1,700	1,397
8 7-May-12	*2	1,700	1,652
9 22-May-12	2	*1,850	1,783
10 6-Aug-12	2	*1,650	1,485

Date	Rating	Target Price	Closing Price
11 9-Oct-12	2	*1,550	1,422
12 28-Nov-12	2	*1,700	1,645
13 6-Mar-13	2	*1,800	1,754
14 5-Jun-13	2	*2,300	1,998
15 25-Sep-13	*1	*2,700	2,346

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

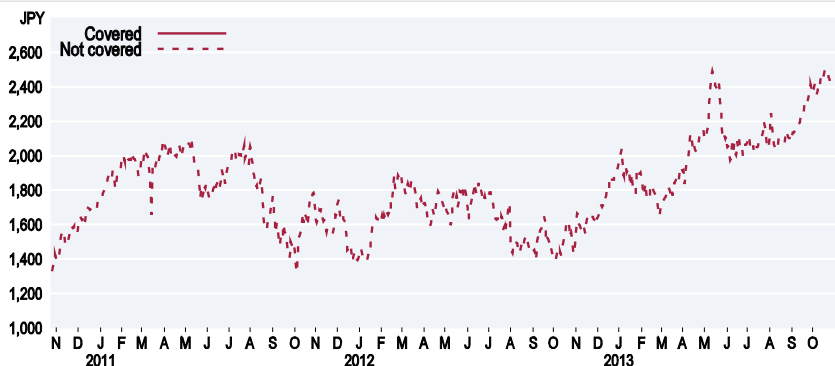
Nabtesco (6268)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Graeme McDonald



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Sep 2013

Citi Research Global Fundamental Coverage

% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
48%	40%	12%	6%	87%	6%
55%	50%	43%	64%	51%	48%

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Citigroup Global Markets Japan Inc.

Graeme McDonald; Lucy Liu

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